RESERVE BANK OF INDIA

AND

RURAL CREDIT

BY

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PREFACE

Credit is important as much for agriculture as for industry. Agricultural credit is not, however, organised so well as credit for industry. Scientific discoveries, technical improvements and the growth of transport have brought about changes of far-reaching significance in every field of economic activity during the last one hundred years. Science has been applied to agriculture also. Hence the farmer requires considerable funds for current agricultural operations, for the marketing of crops and also for making permanent improvements in land. In countries like Denmark, England, Greece, Roumania, Poland, Lithuania, etc., steps were taken by the State to enable persons of small means to buy agricultural holdings which they could themselves cultivate. Encouragement has been given everywhere in Europe and in other continents also, to the development of small family holdings. Hence resort to adequate credit facilities became necessary.

The question of agricultural credit was raised by the Assembly of the League of Nations in 1937. It invited the Financial Organization to study problems of agricultural credit and insurance. Later M. Louis Tardy, Honorary Director-General of the Caisse Nationale de Credit Agricole, Paris, was asked to undertake a study of the problems of agricultural credit in various countries. His report is a classical document on the subject; but as the Financial Committee observed, M. Tardy had "mainly in mind the credit problems which present themselves when a primary object of social policy is rural resettlement, including the adaptation of agriculture to the conditions created by more or

less recent changes in land tenure, or when the object of such policy is to afford support or relief to the agricultural population"

In India agriculture is backward and requires improvement Smallness of holdings, defective land tenure, want of capital rural indebtedness and absence of the use of scientific methods of cultivation are the main problems of Indian agriculture. Agricultural yield is low and it must be increased These improvements require a suitable system of agricultural credit Dr Voelcker in 1889, the Royal Commission on Indian Agriculture in 1928 the Central Banking Enquiry Committee and the Provincial Banking Enquiry Committees *inter alia* have paid attention to problems of agricultural finance in India Recently the Agricultural Finance Sub Committee was appointed to consider the subject of agricultural finance. The various reports on the co-operative movement in India and in different provinces have much to say on the necessity of suitable agricultural credit facilities in the country.

An important aspect of agricultural credit relates to the part that the Central Bank or the Bank of Issue of a country should play in the organization of agricultural credit This aspect has not received as much attention as it should It is necessary that the amount, the form, and the uses of agricultural credit should be adapted to the basic trends affecting world agriculture and to the particular conditions of agriculture in a country. The Central Bank of a country can influence the methods and machinery of agricultural credit to suit the particular conditions of agriculture in the country concerned

Attention was paid to the question of the assistance to be given by banks of issue in respect of

agricultural credit by the General Assembly of the International Commission of Agriculture in its meeting at Oslo in July 1936. It undertook to present a report on this important question at the Seventeenth International Agricultural Congress at the Hague in June 1937. Another publication of the League of Nations entitled *Medium-Term Credit to Industry* points out that "the relationship between the Central Bank and the whole organization of agricultural credit raises difficult problems" and it suggests that the most constructive contribution to the problem would be a critical study of the relationship between agricultural credit systems and the credit systems in general, including the Central Bank.

Accordingly, I have ventured to study the relationship between the Reserve Bank of India and the agricultural credit system of our country. I have tried to study the part that the Central Banks are playing in the organization of agricultural credit in other countries of the world and the part that the Reserve Bank of India is playing and should play in our country. A perusal of the chapter dealing with the Bank of Issue and Agricultural Credit would indicate the importance attached by the Bank of Issue in different countries in providing and organizing agricultural credit facilities. In the light thereof, I have made suggestions with regard to the assistance which can be rendered by the Reserve Bank of India in respect of the provision of agricultural credit facilities to suit the conditions of Indian agriculture. The Reserve Bank of India can function as a true central bank only when it can mobilize the latent financial resources of the country for agricultural improvements. For this purpose all the banking and credit institutions of the country which are now outside its purview must be brought within its ambit. Its Agricultural Credit Department must be entrusted with funds

and the possibility of opening a long term mortgage department should be favourably considered The provisions of Section 17 of the Reserve Bank of India Act should be liberally interpreted

I studied in the Reserve Bank Library in June 1945 and the authorities of the Reserve Bank of India gave me all possible facilities in this con nection The Officer in Charge of the Agricultural Credit Department and others concerned were very cordial and I am grateful to them for the help they gave me in my studies From time to time I have also been writing to them for information on the subject and their response has been prompt Through the courtesy of the Finance Department of the Government of India I was allowed to study the reports of Sir M L Darling on Co operative Movement and on the constitution of the Agricul tural Credit Department of the Reserve Bank of India which were presented to the Government in June 1935 and which are treated as confidential I also wrote to Sir Manilal B Nanavati and to Sir Chunnilal B Mehta and I am grateful to them for the information sent to me For the study of conditions in foreign countries I have utilised the reports and Acts of foreign central banks while for Indian conditions I have studied the various circulars and bulletins issued by the Reserve Bank of India from time to time as also other material bearing thereon.

I addressed a *questionnaire* to foreign central banks seeking information on the part played by them in providing agricultural finance There was good response and the material supplied has enabled me to examine foreign practices in the light of that information to see how far they can be applied to Indian conditions with the necessary modifications I am very grateful to the authorities of foreign central banks who supplied this information I

have given extracts from the replies received from foreign central banks as Appendix B

I also studied a number of books and reports in preparing this thesis, which have proved very valuable, and I express my grateful thanks to their authors

I hope that if this work of mine were to see the light of day, it might be helpful in throwing some light on the subject. In that case I would *regard my labour amply rewarded*

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CHAPTER I.

INTRODUCTORY

Importance of Credit in Agriculture

It is not possible to carry on modern productive enterprise without capital owned or borrowed, which can be used to assist the various processes from the very first step in production to the final state of consumption Each step in production is facilitated and rendered possible by the availability of capital Instruments of production must be made available, and stocks of goods in various forms from the raw-materials to the finished product are necessary in order to maintain continuity of output Agriculture is no exception although there are special elements in agricultural organisation which distinguish it from other industries These special features of agriculture must be taken into consideration in assessing the value of credit system suitable for the industry In fact, the general problems relating to credit are practically the same in agriculture as in other industries, but the differences in degree are so great as to constitute a special rural credit problem and to require separate study One of the peculiar features of agriculture is its persistent small scale organisation, There is a tendency in other industries towards concentration in units of expanding size, but agriculture remains scattered and individualistic The result is that as a producer the farmer remains dependent upon his own resourses The savings of the general community are generally inaccessible to him.

Special Features of Agriculture

In agriculture, the turnover of working capital is slower than in other industries Agricultural crops can be harvested and sold only periodically, but in other industries goods can be sold from time to time In other industries processes of production can be speeded up by shift system overtime work and by other methods but it is not possible in agriculture

Agriculture depends mainly on the resources and administration of one man It requires constant and whole-time nursing It is not possible for a tenant farmer to leave his field at any appointed hour It is not possible to reduce output in agriculture when demand decreases and prices fall in times of depression The farmer is not only an *entreprenuer* but he is also the principal labourer of his enterprise Mainly he employs the labour of the members of his family He cannot, therefore cut down costs by reducing labour Thus production goes on in agriculture in spite of depression in prices That is the reason why the prices of farm produce fall more than the prices of manufactured goods

Fluctuating demands for capital are a feature of farming The greatest fluctuations in capital demand occur in working capital The period between the first step in production and the ultimate marketing of the farm produce is often long Costs are incurred in preparing the land providing raw-materials such as seed and fertilizers paying wages providing food and clothing and for other purposes associated with the processes of production before the actual returns are received This time lag is more pronounced in the case of wheat and other annual crops but it is far less apparent in dairy and in certain type of vegetable products where returns are more frequent The period between the gather-

ing and the actual marketing of the produce is long, particularly where the farmer desires to hold his produce till a favourable market Hence a great deal of capital must be laid out in meeting costs of production and marketing before returns are received.

There are vagaries of weather and markets There is risk of diseases and pests Hence the farmer unlike the manufacturer in secondary industries, can seldom forecast with any reasonable accuracy the extent of his returns Disease or weather conditions may affect the operations to such an extent that the returns may fall below the outlay On the other hand, a bumper season or a particularly favourable market may give returns in one season which considerably reduce the demand for capital for productive enterprises in the next season 'This persistant variation in returns causes continued variations in capital necessary to provide for the costs incurred in the ordinary processes of production and marketing"[1] There are differences in size of farms, in the operations carried out on them, in their tenures and in their climatic location There are also differences in organisation on the farms, in the degree of establishment and in the processes of marketing and distribution Thus differences occur from district to district and even from farm to farm within a locality. Thus there are great variations in the demands for capital and the needs of each individual property must be separately assessed. These variations will show the weakness in farm credit system which separate the source of long-term, intermediate and short term capital or which fix rigid terms of repayment applicable alike to all cases.

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1 Page 6, Fifth Report of the Rural Reconstruction Commission of Australia, 1945.

Features of Indian Agriculture :

In India the special characteristics of agriculture must be emphasised which should be taken into consideration in evolving a suitable credit system Agricultural holdings in India are small and fragmented The produce from land per acre is very low Cultivators are ignorant and illiterate In many places the rights of cultivators in land have been so restricted by custom or legislation that practically no security for credit is available Agriculture in India is carried on more as a mode of living than as a business proposition.

These factors must be taken into consideration in evolving a suitable credit machinery for agriculture Hence It follows that any system for a provision of credit for farming would be required to serve a wide variety of needs [1] A type of credit service suitable for dairy farming may not meet the needs of sheep farming or the mixed farmer The farmer, who is developing his farm, may require different treatment from that given to the farmer whose farm has grown into a commercial enterprise A mortgage institution may not meet the requirements for equipment and working capital, and it would be no use to the tenant farmer or share farmer There are demands for long-term loans, for loans for intermediate periods and loans for short periods The convenience of borrowers may be met in different ways according to the case and the circumstances The type of security available, degree of Irisk involved and the nature of the operations in the production and marketing are factors which require varying arrangements

Elasticity of Credit :

A suitable credit system must provide elasticity of credit. Up to a certain point the need

1 Ibid page 14

for capital usually remains more or less stable. Above that point, the capital outlay will fluctuate according to seasonal requirements and conditions A farmer may be able to provide all his capital, but if he retains in his business all the required capital, he will have idle funds at different periods. He cannot invest the idle funds It is, therefore, necessary that the cultivator may rely on credit for his fluctuating needs.

Forms of Credit

The credit needs of farming may be considered with reference to objects period of time and security Each of them is related to one another Short term credit is required for current expenses of production and for the marketing of crops In this category are also included the expenses of maintaining the farmer and his family until crops are sold Crop production loans relate to the purchase of manures seeds and the like There are four main requisites of short-term credit according to the Madras Banking Enquiry Committee[1] Firstly, such loans should be made available in small sums spread over a period of about nine months and they should be repaid from the sale proceeds of the crop Secondly, the loans mtst be made available at short notice to enable the cultivator to undertake operations in time Thirdly, the amount must be adequate Finally, the rate of interest must be reaso nable; otherwise cultivation will not be profitable The co operative agency is the most suitable machinery for such loans Short-term advances for marketing the produce are made so that the cultivator may be able to withhold crops in anticipation of better prices According to the Preliminary Report of the Reserve Bank of India, this type of credit should be regarded as an important part of banking business, but commercial banks are not

1 Paragraphs 129 and 131 of the Report.

handling this business to a very great extent because of the vagueness of marketing conditions in the country. Mostly this business is done by the indigenous banker or any importing and exporting houses with upcountry agents. The most suitable security for this is personal security or the promissory notes of the borrowers. Warehouse receipt representing title to crops held in store is a suitable security for marketing credit

Intermediate credit is required for purchasing cattle and implements Usually this credit is required for about one to three or four years It cannot be repaid out of the proceeds of the current year's crop The common security in this case is the form of titles to the ownership of property like bonds, insurance policies, and the like They are not, however, developed in our country. In India the period of such credit must be put up to five years.

Long-term credit is required for a period varying from three to thirty years for purchasing land and making permanent improvements It is also required to repay past debts. According to the *Preliminary Report of the Reserve Bank of India*, "the last is the most important and if any effective steps are to be taken to make the agriculturist creditworthy this is the first problem which must be tackled[1] One of the essential features of long-term rural credit is that the money borrowed should be sufficient to enable the cultivator to carry on his business, and secondly, such loans should be repayable from the margin of profit *of the holding of the cultivator without starving his current* needs Long term credit machinery can be called effective only if the cultivator has not to borrow from other sources and he is not compelled to sell holdings to repay the loan. The maximum period

1. Page 12 of the Report.

allowed for such loans is 30 years in Finland, 42 years in Australia, 54½ years in Austria, 33 years in Chile, 33½ years in New Zealand, 60 years in Denmark, 63 years in Hungary, 60 years in Italy and Japan, 57 years in Switzerland 68½ years in Ireland and 75 years in France[1] In India unfortunrtely no clear distinction is drawn between loans required for short and long periods.

It is thus clear that the threefold classification of agricultural credit based on objects, period of time and security is interdependent. In fact the period of loan is of great importance to the farmer from the point of view of security and convenience The capital thus provided must be available to him long enough to cover the period of production for which it is required and to enable repayment out of income If he is obliged to renew the loan he incurrs extra costs, and if the time of renewal happens to coincide with a period in which little credit is available, the cultivator may be embarrassed by difficulty in getting renewal or may be charged exorbitant rates A loan obtained for seasonal operations may also prove embarrassing if it is repayable on a fixed date. The crop must be ready, but market conditions may be very unfavourable Hence the farmer may be compelled to sell his produce at a low price to repay the loan. Alternately, he may have to pay unreasonable terms for extension of time. This does not, however, imply that cultivator should be given unlimited extension to hold the produce from the market; but it does imply that credit arrangements should permit of a reasonable period in which discretion may be exercised according to circumstances Thus the period of a loan should not be rigid, but it should be capable of being adjusted to the changing needs of the cultivator

1 Herrick Rural Credits page 111

Agency :

This brings us to the question of agency to supply rural credit It would be desirable if all the credit needs of a cultivator were met from one source. It would lead to economy and convenience for the cultivator , but in practice it is not possible. An agency which can supply loans for short periods may not be able to meet the long-period needs. In India of course the money-lender supplies all the needs of the cultivator , but this system is associated with great abuses Short term credit needs can best be met by co-operative agency , whereas long-term credit needs can be met by institutions like land mortgage banks which should lend money on the security of landed property for long periods of time In England, long-term loans are provided by the Agricultural Mortgage Cooperation at 4½ per cent. rate of interest for a period of 60 years. In New Zealand the Bank of New Zealand opened a special department in 1933 to provide long-term credit to the cultivators. It paid 7¾ per cent. interest on debentures but charged only 6½ per cent. per annum from the cultivators. The Bank more than made up this loss by getting the other business of the borrowing farmer for itself which would otherwise have gone elsewhere.[1] In South Africa, settlers received assistance from the Land Ministry in the form of loans repayable in 40 years for purchasing land and for making permanent improvements in land. Thus special institutions have been evolved in foreign countries which specialise in meeting the short-period needs and long-period needs of agriculturists.

Criteria of a Sound System of Agricultural Credit :

Tardy's Report mentions that a suitable system

1. Qureshi State Banks for India

of agricultural credit should confirm to the following criteria[1].

(1) It should be granted for a sufficiently long period, commensurate with the length of the operations which it is designed to facilitate,

(2) It should be granted at a low rate of interest,

(3) It should be adequately secured, in order, more particularly, to avoid any abuse of credit facilities, but the security should not be necessarily material, it should, if necessary, be in the form of a personal credit secured mainly by the borrowers' moral standing and farming abilities,

(4) It should be adapted to the average yield and capacity for payment of the farmers, particularly during periods of economic depression, and

(5) It should be placed in the hands of institutions, the directors of which have received special training and had actual banking experience

Here we may point out that credit alone will not solve the problem of agriculture in any country It cannot convert an unprofitable industry into a profitable one Credit may enable an individual to make certain operations pay which might not otherwise pay or might not otherwise be undertaken at all. What is necessary is that the cultivator must be made creditworthy Profits from agriculture must be increased by improving the organisation of the industry The handicaps which impede cultivation must be removed, if Indian agriculture is to be put on a sound footing As observed in the Preliminary Report of the Reserve Bank of India, "If the agriculturist is to get the credit necessary for the development of the industry, he must first be made creditworthy.[2] Thus

1 Systems of Agricultural Credit and Insurance, page 75
2 See page 42 of the Report

credit must be linked to the productive capacity of the agriculturists Credit alone will not solve the problem without adequate improvements in the economic condition of the cultivator But of course, given that, credit facilities must be considerably improved, for their absence implies great handicaps in the way of agricultural improvements

CHAPTER II

AGRICULTURAL INDEBTEDNESS IN INDIA

Historical Survey:

In any scheme of agricultural reorganisation and reorganisation of agricultural credit in India it is necessary to pass under review the existing information regarding the debt situation of the agricultural producer Conditions of agricultural production and finance differ widely from place to place so that it is difficult to present any general picture Statistical information bearing on agricultural economic conditions in India is inadequate The situation is better in respect of agricultural indebtedness Investigations were undertaken by the provincial Banking Enquiry Committees and the Central Banking Enquiry Committee into this problem Before them the Deccan Riots Commission of 1875 and the Famine Commission of 1880 gave an idea of agricultural indebtedness Sir Edward Maclagan in 1911 also gave an idea of agricultural indebtedness and put the total debt of British India at about Rs 300 crores and Mr Darling put the figure at Rs 600 crores The Central Banking Enquiry Committee put the estimate at Rs 900 crores

Agricultural debt increased considerably during the British rule According to the Royal Commission on Agriculture in India, 'It is more than probable that the total rural indebtedness has increased in the provinces" According to the same authority, "The worst policy towards agricultural debt is to ignore it and do nothing' Thus in any scheme of reorganisation of agricultural credit in

our country great importance must be given to the problem of agricultural debt

Since the reports of the Banking Enquiry Committee no comparable all India review of indebtedness has been made but extensive surveys of provinces give information regarding the changes that have taken place in this connection The Agricultural Finance Sub-Committee which was appointed in September 1944 appraised the present debt situation and it estimated the nature of the financial problem before the agriculturist in the post-war period It also indicated in a general manner how this problem could best be tackled According to this Committee The determination of the total volume of present debt was not an important preliminary for the work of the Committee [1] It was however regarded necessary by the Committee to appreciate the nature of the rural debt situation in India before making its recommendations regarding the reconstruction of agricultural finance

Two main events of the last two decades deserve attention Firstly, it is necessary to estimate the effects of the agricultural depression of the pre war period on the total debt situation and secondly the changes in the economic situation of the cultivator during the War should be reviewed The burden of the debt increased during the depression period *A priory* considerations lead to this conclusion It is also supported by information available from the enquiries conduced in different provinces According to the United Provinces Debt Relief Committee of 1938, the payment of interest and principal had been suspended all over the province New loans were made on a much smaller scale than before but they were generally

1 Page 9 Paragraph 2 of the Report

of larger amounts than those of repayments The total burden and the current charge in money terms relating to the debt on agriculturists had increased during the depression The report of the Bengal Board of Economic Enquiry of 1935 on rural indebtedr ess confirms this conclusion Comparing the burden of average debt in 1933 with the burden of debt in 1928, the report pointed out that the burden of debt had increased substantially in money terms It was also revealed that generally there was no surplus of income over expenditure The same conclusion was arrived at in the survey made in Madras in 1935 by Mr Sathianadhan

Debt and Depression .

It is obvious that the depression increased the *money burden of the debt during years immediately* after its onset we cannot, however, say that ultimately the burden should be stabilised at higher values than formerly Many factors would exercise their effect on the situation Firstly, assets would change hands leading to the cancellation of the debt concerned Secondly the creditor would not be able to recover claims in full Hence there might be a considerable scaling down of debts Thirdly, the new debt would be required on a smaller scale and would also be available in smaller quantities. Hence the accrual of debts after some years of depression would be less than those of the pre-depression period. Unless therefore it could be shown that the debt before the depression was of an accumulating character and could not be cleared by processes mentioned above, the total debt in 1938 or 1939 should not have been higher than in the pre-depression period. It is not, however, possible to arrive at definite conclusions in this respect. In this connection the Agricultural Finance Sub-Committee observes that "That immediate effect of the depression was obviously to increase

somewhat the money burden of the debt and very considerably its real burden "[1]

Effect of the World War II

We are no better situated in respect of statistical information to judge the effects of War on agricultural indebtedness The Reserve Bank of India made enquiries with the help of provincial and other governments These enquiries suggest that the agricultur sts tried to liquidate their old debts to the money-lenders to the co operative societies and to Government Available information shows that there was a general tendency towards repayment The outstanding advances made by governments under the Land Improvement Loans Act and the Agricultural loans Act were distinctly lower in the war period that in 1993 Secondly, co-operative societies in most provinces were able to reduce their overdues substantially The advances made by them during the War were on a smaller scale than before the war The amount of overdues of agricultural societies in 1940-41 was about Rs. 10½ crores, while the corresponding figure for 1942 43 came to Rs. 9 crores. Thirdly, a considerable volume of advance repayment was recorded in the case of land mortgage banks. In a circular issued by the Reserve Bank of India in August 1943 it is pointed out that the agricultural incomes increased during the War and that the burden of debt must have become lighter so that the agriculturist should be in a better position to liquidate his liability. The Famine Enquiry Commission of 1945 pointed out that in the absence of reliable statistics "it is impossible to estimate the extent of the reduction in agricultural indebtedness as a result of the high prices for agricultural produce. The replies which we have received indicate, however, that there has been a substantial reduction in all pro-

1 Page 8, Paragraph 11 of the Report.

vinces[1] On the strength of the evidence it may be possible to say that the total indebtedness in terms of money was lower in the war period than it was in 1939 All classes of cultivators may not have been benefited from the rise in prices but the substantial cultivators and big landlords everywhere repaid their old debts to a great extent Taking *India as a whole it may be said that rural debts and* their total money burden may have become lighter but it is not clear whether increased income was everywhere utilised for reducing old debts and that it was not being used for either greatly increased consumer expenditure or in buying land at highly inflated prices It should be remembered that the years to come may not necessarily be profitable to the agriculturists It is likely that forces leading to increase of agricultural indebtedness might again become operative It is therefore necessary that efforts must be made to bring about a general adjustment of the debt burden and to raise a new structure of agricultural finance as part of the general reconstruction of the economy of the Indian agriculturist

General Features

Certain general features may be given about the Indian agricultural debt situation which are based on the investigations of the Banking Enquiry Committees They have to be taken into consideration in any *scheme of the reconstruction of the rural* credit system of the country Firstly the repayment of old debts is everywhere an important factor in the construction of new debts According to the Bihar Banking Committee the repayment of old debt was responsible for 18 per cent of the total debt amount of the province the corresponding figure given by the C P Banking Committee was 26 per cent while the figure given by the

1 See Chapter II of the Report

Bombay Provincial Banking Committee was 20.7 per cent. The inquiry of Mr. Sathianadhan in Madras referred to above put the figure at 25.1 per cent. In 1937, the Agricultural Credit Department of the Reserve Bank of India made an inquiry into the working of the land mortgage banks, which showed that in the case of 43 banks from whom replies were received loans for liquidating old debts formed 98.6 per cent; of the total advances made as against 38 per cent advances for improvement of land. All this implies the cumulative character of the Indian agricultural debt. Thus Indian rural debt is onerous in character Secondly the part played by unproductive purposes is considerable. Everywhere social and ceremonial expenditure absorbs a considerable percentage of the total burden of debt. The raising of debt for this purpose does not increase the efficiency of the cultivator. This leads to the accumulation of the burden of debt Thirdly, in most surveys purely consumer needs are seen to play an important part in contributing to the total debt of the peasant. Finally, debt contracted for development purposes like land improvement is insignificant in amount.

Necessity of Reorganising the Debt Burden :

Reduction of debt burden to a figure which is within the repaying capacity of the peasantry is indispensable in any scheme of the reorganisation of agricultural finance. This, however, requires the availability of adequate statistical information which unfortunately is lacking at the present time in our country. Before the burden of agricultural debt can be reduced the effect of wartime rise in prices has to be known with a certain degree of accuracy. Systematic efforts should be made in this connection. The Reserve Bank of India issued a circular to the registrars of co-operative societies requesting them to find effects of rise in prices of

primary commodities during the war Their replies show that cultivators were making efforts to repay their debts The reports of some registrars, however, stated that there was no appreciable increase in recoveries because the smaller peasants were not benefited by rise in prices.[1] The replies also indicated that systematic efforts were not made anywhere to ensure that the increased income was utilised for liquidating old debts The big land owners and substantial cultivators were benfited considerably A large part of the benefit however, went to the middleman particularly in the early part of 1943 In reality, the rise in agricultural prices was also accompanied, and is being accompained even now (1947) by a general rise in the cost of living The cultivator has to purchase many things at black market prices which are far higher tha n control prices Hence we may conclude that the rise in agricultural prices is even overtaken by the rise in the cost of living

Method of Collecting Information :

The Reserve Bank of India addressed a letter to the provincial governments to make enquiries into the problem of the effects of the war time rise in prices of cultivators The latter pleaded their inability to do so as they were busy with war work They pointed out that the necessary staff could not be spared. Even today the provincial governments are preoccupied with very urgent problems All the same, the collection of information is indispensable It is, however, possible to carry out sample inquiries in typical areas through some other agency The method of sampling in place of the method of detailed province-wide investigation can be tried in each province The actual indebtedness of a sufficiently large number of individuals can

1 This was the view of the registrars of co-operative societies of Travancore and Bengal

be found This inquiry can be put in charge of an economist in every province, who should be appointed by provincial government in consultation with the Universities. Suitable programme can be chalked out in consultation with the registrars of co-operative Societies, with the Boards of Economic Inquiries and with the Departments of Economics and Statistics The scheme should include a comprehensive questionnaire in respect of the amount of agricultural indebtedness and the way in which the War affected the situation in this respect In actual field work the economist should be assisted by lecturers research students and others who are familiar with local conditions. Attractive honorarium should be paid to workers On the basis of this information reports can be prepared for the information of the Government which should be forwarded to the Reserve Bank of India. This information can be obtained by co-operation between the provincial governments, the Government of India and the Reserve Bank of India, and on its basis a suitable programme can be prepared.

The Economic Research Department of the Reserve Bank of India should also be prepared to undertake this inquiry A portion of the annual profits of the Bank should be set apart specially for purposes of economic research Regular staff can be engaged for this purpose to remain at the Headquarters in Bombay or in branch offices. Properly qualified field investigators can be appointed The central and provincial governments can also earmark annual grants for this purpose. In this way adequate information can be made available, on the basis of which a new system of agricultural finance can be set up in our country.

Two important facts emerge from the above discussion. Firstly, the repayment of old debts is an important cause of the new debts, and secondly, the debt is largly borrowed for unproduc-

tive purposes and not for development purposes. In any future scheme of agricultural finance, fresh debts should be incurred for development purposes The most important condition for raising such a financial structure is, therefore the readjustment of existing debts They should be considerably reduced so as to be related properly to the economic condition and needs of the cultivator When the burden of the existing debts has been readjusted, repayment will be made by annual instalments over a number of years. The new agricultural financial system will also require some structural changes in the agricultural credit machinery and a proper co-ordination thereof with the Reserve Bank of India will be necessary The purposes for which borrowing is made today indicates the defects of the existing agricultural economy Freedom from debt today does not imply that the cultivator is well off and does not require finance or credit The fact of the matter is that in many cases the rates and conditions under which finance is available make it unprofitable for the producer to use it for productive purposes In future a thorough use should be made of the land and capital resources by peasants Hence many of those who are free from debt today would require finance on reasonable terms In fact, freedom from debt might be as much a sign of lack of credit as of financial strength. In this connection, it should be assumed that reconstructed finance will be accompanied by a reconstructed agricultural economy under which finance for payment of rent or revenue will not generally be required if the instalments of these payments are properly spread over Secondly, borrowing on account of consumer needs of the family will disappear Thirdly, the need for productive finance will considerably increase both for current production needs and for development purposes It may, however, be pointed out that financial reconstruction can be successful only if all

problems of agricultural economy are tackled as a whole It means the attempt to raise a sound system of finance should be a part of the general programme of agricultural reconstruction There should be a balance between agricultural and industrial employment to bring into existence solvent agriculturists. This will require the constitution of economic holdings the reform in land tenure security of water supply and the like

A cultivator borrows to repay an old debt either because of a defect in the system of credit which means that the terms and period of repayment were not properly fixed when the debt was contracted or it implies a defect in the economic situation of the borrower which may be because of inadequate capacity This situation has a dragging effect on the economy of the agriculturist It imposes an extra charge on the current income which is already insufficint This must lead to insufficient finance for current production and to a fall of the standard of living The fact that the repayment of old debts is important in the incurring of new debts in all parts of the country shows that old debts have adverse effects on the economy of the average agriculturist The problem, therefore, is the readjustment of the burden of old debt to a point which is well within the repaying capacity of the cultivator This is necessary to enable the new system to function properly

A Survey of Efforts made to Readjust Debts.

At this stage we may review the attempts made in the past to readjust debts in India. They may be divided into two periods efforts made in the predepression period and those made in the depression and post-depression period The efforts made in the pre-depression period before 1930 were sporadic and localised They were mostly temporary palliatives which did not achieve any lasting effects

The earliest of these efforts was made in the Central Provinces during the famine years of 1897 to 1900. The local panchayat was used as conciliation agency under the supervision of a Government officer Interest rate was regulated The debtors and creditors were called upon to present their liabilities and claims. The total debt conciliated during this period came to Rs. 206 29 lakhs and the amount remitted was Rs. 121 71 lakhs[1] Another attempt was made by passing the Deccan *Agriculturists Relief Act of 1879 which* authorised the Courts to go into the history of the debts, to reduce unreasonable charges by way of interest and to spread the payment over in instalments. The debtors and creditors could apply to conciliators appointed by the provincial government to make an amicable settlement of the debt, but the provisions relating to conciliation were repealed in 1911 because they could not achieve much In 1899, the Contract Act was amended under which Courts were empowered to give relief to debtors if bargains were proved to be unconscionable. But this provision was not successful because as pointed out by the Bengal Provincial Banking Enquiry Committee it was difficult to prove that the bargain was unconscionable.[2] Money-lenders were mostly men of education and intelligence and borrowers were generally ignorant and illiterate The Usurious Loans Act, 1918 was another measure It authorised the Court to reopen the transaction and to relieve the debtor of all liability in respect of excessive interest, if the Court found that the interest was excessive and the transaction unfair. According to the Royal Commission of Agriculture in India this Act was practically a dead letter although the Central Banking Euqury Committee did not think so. The

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1 Report of the Agricultural Finance Sub Committee p 16

2 See page 164 of the Report

Land Alienation Acts of the Punjab were also efforts of the State which indirectly reduce the volume of indebtedness

Legislative Activity

In the depression period which began in 1930 the acuteness of the problem of the agricultural debt and the need to deal with it properly were brought to the forefront This period witnessed a considerable legislative activity in respect of agricultural indebtedness The provincial governments amended the Usurious Loans Act to make it more effective The Law of Dumdupat was made applicable in several provinces The provisions regarding arrest and imprisonment of judgment debtors were abolished in some provinces The most important measure of relief was the provision for debt adjustment through Debt Conciliation Boards and the Debt Relief Courts Debt Adjustment through Boards was voluntary and debtors and creditors could apply to the Court for adjustment of debts The debtor was to be asked to submit a complete statement of his assets and liabilities, and the creditor a list of his claims within a definite period of time If the creditor did not file the claims, they were to be taken as having been discharged unless reasonable grounds to the contrary were proved If the creditors came to a settlement with a debtor, the settlement was put down in writing, indicating the amount of debt to be repaid and the manner of repaying it Details varied from province to province In C P Debt Conciliation Boards were abolished in 1939 and Debt Relief Courts were set up in their place The Courts were empowered to reduce debts according to prescribed scales The transactions made 12 years before the last transaction or before 1st January, 1932 whichever was earlier, could not be reopened by the Court. The date on which

each loan was originally advanced was then ascertained and interest was then calculated. Provision was also made to reduce the principal amount. The Act expired in July 1942; but it was extended for disposing of the pending cases. The Relief Acts in Madras and Sind also provided for the scaling down of small agriculturists by the Courts more or less on the C P. model.

Extent of Relief Given:

Under these Acts, relief was provided to the debtors Information collected by the Reserve Bank of India shows that the debtors appear to have received a fair amount of relief. In Bengal till the end of March 1944, a total debt of over Rs 50 crores was scaled down to about Rs. 18 crores, representing a reduction of 64 per cent. In Central Provinces and Berar a debt of about Rs. 16 crores was scaled down to about Rs. 7¾ crores or roughly 50 per cent In Madras and C.P. the claims amounting to about Rs 9¼ crores and Rs. 4¾ crores respectively were scaled down to about Rs. 4¼ crores and Rs 3[illegible] crores respectively.[1] Information exisits to show that before the present boom period began defaults on the part of debtors were not uncommon because they were not anxious to pay their obligation. According to the Information collected by the Agricultural Credit Department of the Reserve Bank of India, the debt Acts had weakened the sense of morality of the people[2] Even agriculturists who could pay were unwilling to pay in the hope of getting further concessions.

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1 See cyclostyled summary prepared by the Reserve Bank of India on provincial legislation for the relief of agricultural indebtedness Also see report of the Agricultural Finance Sub Committee, page 22

2 See the Conference number of the Indian Journal of Economics, 1937

Absence of Permanent Solution:

The above measures did not provide any permanent solution of the problem of agricultural indebtedness They were intended to meet situation which arose on account of the sudden fall of agricultural prices Debt conciliation under the various Acts was voluntary Money-lenders also were not responsive to the provisions of these measures because there was no agency to pay the debts which were scaled down. The Bombay Agricultural Relief Act of 1939 was an exception to the above legislation Its aim was not merely to grant immediate relief but it was intended to solve the chronic problem of agricultural indebtedness *Under it there was to be a compulsory* adjustment of debts not exceeding Rs 15,000 by Debt Adjustment Boards established in different areas Every debtor and every creditor has to apply to the Board within a certain period of time for the adjustment of the debt The Government, the local bodies and the co-operative societies are to intimate to the Board the amount of remission they are prepared to give In other cases, the Board is to examine each case, determine the fair amount due and reduce it according to prescribed scales This reduction depends on whether the debts were incurred during or before the depression, The amount was to be reduced to the paying capacity of the debtor. Thereafter the Board was to make an award for their repayment in instalments whose number could not exceed 25 and each instalment could not exceed the debtor's net annual income Net annual income is defined as the balance of annual income left after deducting charges for maintenance of the debtor and his dependents and for repayment of loans borrowed for financing crops and of debts due to Government and local authorities Private settlements are void

unless submitted within 30 days to the Board which would certify them if they were *bonafide* and in the interest of the debtor The creditors are given the option to receive payment in instalments spread over a period not exceeding 25 years, or immediate payment in Government guaranteed bonds to be issued by the Provincial Land Mortgage Bank or other authorised banks. The creditors could exercise the option of getting payment in bonds provided the reduced amount did not exceed 50 per cent of the value of the immovable property of the debtor. The debtor can be declared insolvent if his paying capacity is inadequate. This measure was passed in 1939 but brought into force in 1942 Since then it has been extended to more areas, but it is yet too early to judge the results of its working.

Necessity of Special Machinery:

This situation created by the depression was eased because of the rise in agricultural prices and agricultural prices have been rising in the post war period. The monthly average index of wholesale prices of agricultural commodities in June 1945 was 256 It rose to 303 in June 1946, and to 358 in June 1947[1] In view of this rise, it may not seem fair or wise to scale down agricultural debts universally when the creditor is hit hard and the debtor has gained by the fall in the value of money[2] It may be said that this rise in prices has not benefited all classes of cultivators uniformly Costs of cultivation and of production have increased proportionately and it cannot be said that the problem of

1 See Reserve Ba k of India Bulletin, August 1947 page 507

2 See I 1 an Co operative Review April June 1947 Future of Agricultural Finance by Ramakrishnan pages 74 to 81 The writer argues that it is not necessary t compulsorily scale down debts any further as he does not agree with the view of the Agricultural Finance Sub Committee that the work of adjustment of agricultural debts of millions of cultivators accordi g to the repaying capacity of each s an be finished within two years

accumulated debt has been eliminated According to the Famine Commission of 1945, "The healthy functioning of the rural credit system is, therefore, bound up with the question of the reduction of indebtedness"[1] It is thus necessary to reduce the accumulated debt to a level where it may not hamper productive activity. It should then be paid off in instalments so that the producer may be able to finance current production. The Agricultural Finance Sub-Committee suggested the setting up of a special machinery for this purpose. According to it the debts of agricultural producers who have transferable interest in land should be compulsorily adjusted, while those of producers who have no such interest in land should be taken up for compulsory adjustment only on application made by the borrowers. The work of adjustment should be entrusted to Boards consisting of judicial officers. The Committee suggested that the work of adjustment should be completed within two years. All creditors should submit their claims against agricultural producers within a specified period of time. The debtors should also be made to submit a statement of their assets and liabilities before a definite date. The adjustment agency should scrutinise each account and go behind the entries as provided in the Deccan Agriculturists' Relief Act. The Committee also pointed out that the Law of Dumdupat should be applied and in no case should the total repayment exceed double the amount of principal originally lent. Further, the present value of the debtor's normal repaying capacity should be assessed and reduced to half the *value of his immovable property or the present* value of his repaying capacity, whichever is less; but a secured debt should in no case be reduced below 50 per cent of the value of the property on which it rests In the case of agriculturist debtor

1 See page 298 of the Report

having no transferable rights in land, the adjustment of his debts should depend upon his repaying capacity If the adjusted debt exceeds his total repaying capacity by a given proportion, the debtor should be adjusted insolvent Similarly, when the fairly adjusted debt of an agriculturist debtor, having transferable rights in land, exceeds by a given proportion prescribed by law, his total repaying capacity or half the value of his immovable assets whichever less the Board should adjudge him insolvant It may be pointed out that the Royal Commission on Indian Agriculture as also the Indian Central Banking Enquiry Committee recommended such agricultural debtors to be declared insolvent We agree with these views and hold that unless agricultural debts are reduced to a level within the repaying capacity of the cultivators no system of agricultural finance can work properly.

It will be necessary to ensure that all the scaled down debts should be paid off to the creditors immediately The money to pay off the creditors may be obtained from the land mortgage banks who will not find this business to be an economic proposition Difficulties will arise where land Alienation Acts are in force They may have to be suitably amended to enable the land mortage banks to pay up the amounts and to realise the value of securities in the event of default on the part of agriculturist debtors Hence it is necessary that the effects of the War on the agricultural indebtedness should be estimated to find out the exact position. Steps should then be undertaken to create a new machinery of agricultural finance which may work successfully in the country.

CHAPTER III

Agricultural Credit Agencies in India The Money-Lender Introductory:

In this and the following chapters we shall discuss the place of various agencies engaged in agricultural credit in India and the relationship between them and the Reserve Bank of India as the central banking institution of the country will be appraised The money lender the indigenous banker commercial banks the co-operative movement the Government and other institutions like insurance companies and trading corporations are participating in providing agricultural finance At the top is the Reserve Bank of India which through its Banking Department is prepared to provide finance for agriculture through various agencies *engaged in agricultural credit and through its* Agricultural Credit Department it is studying questions pertaining to agricultural credit and is collecting a great deal of material bearing on agricultural credit in India and in foreign countries Each of these agencies is constituted to perform certain functions only It cannot discharge functions for which it is not organised and it cannot confer benefits which do not and cannot flow from its peculiar activities

The Money Lender

Of all the agencies engaged in providing agricultural finance the individual money lender is by far the most important both from the point of view of number and volume of business This is indicated from the following estimates made by some of the Provincial Banking Committees

United Provinces :—Town money-lenders, 28.3, Village money-lenders, 5. 1, Landlords, 39 9, Tenants, 13. 7 Co-operatives, 2 89, Government, 2. 6.

Central Provinces — Mahajans, 82.71, Landlords 11 8 Co-operatives 2 89, Government, 2 6

Madras .— Money-lenders, 31 Ryots, 47 Co-operatives 17 Government 3

Thus it is clear that money-lenders play a predominent part in providing agricultural credit facilities, but usually they charge high rates of interest which vary from place to place. According to the Provincial Banking Enquiry Committee, in the Central Provinces the tenants having no transferable rights could not obtain accommodation at less than an average rate of 25 per cent, whereas in Maharashtra in irrigated tracts the average rate varied from 12 to 24 per cent, but in famine tracts it varied from 18¾ to 36 per cent. In the United Provinces the most common rate for a loan on mortgage land was 12 per cent but the rates for unsecured loans vary from 18¾ to 37½ per cent, the most common rate being 24 per cent.[1] According to the Bengal Famine Commission the rate of interest in the U P. ranges from 25 per cent to 100 per cent[2]

Importance and Methods of Business

No reliable data are avilable about the number of money-lenders in each province, but the Punjab Banking Enquiry Committee put their number at 55 000, of whom over 17,000 had got themselves registered up to 1940 In the Central Provinces the number was 39,000 of whom about 38 000 were registered up to 1940 In Bombay the number was *20,000 including indigenous bankers The Central* Banking Enquiry Committee put the figure of

1 See page 5 of the Report of Agricultural Finance Sob Committee

2 See appendix B page 186 of the Report.

agricultural debt of India at about Rs 900 crores In 1944-45 the loans advanced by primary agricultural societies came to about Rs 15 crores Commercial banks made advances to the extent of about Rs. 22 crores in 1942 while the loans due to land mortgage banks in India from individual members amounted to Rs, 30.48 crores at the close of 1944 45 Other agencies play a smaller part in providing agricultural finance. Thus the money-lender is the most important agency providing agricultural finance in India According to the Indian Central Banking Enquiry Committee 'In many parts of India the money lender is the only financing agency available to the agriculturists . The money-lender is an indispensable feature of Indian *Rural Economy His methods of business are simple* and elastic and he is easily accessible There is close personal contact between him and the borrower He can accommodate persons without tangible security and yet protect himself against loss owing to his local knowledge, experience, and presence on the spot. As observed in the statutory report of the Reserve Bank of India 'It is well-known that bulk of agricultural finance is supplied by the money-lender'[1] The term money-lender includes the professional moneylender as also the landowner and the agriculturist Merchants, traders and the casual money-lender, pursuing various occupations but lending out their surplus money as pleaders pensioners widows and priests are included in the term According to the Famine Commission of 1945 there are two classes of money lenders (1) the professional money-lender who is more common and who combines money lending and trade, and (2) the non-professional money-lender who, in most cases , is drawn from the ranks of landowners and well to-do agriculturists[2]

1 See paragraph 10 of the Statutory Report 1937

2 See page 294 of the Report.

Questionable Practices

There are questionable practices connected with money-lending, the common forms of them being (a) demand for advance interest, (b) demand for a present for doing business known as *Girah Kholai* (purse opening) (c) taking of thumb impression on a blank paper to insert any amount at a later date, if the debtor fails to pay the amount of interest (d) general manipulation of the account to the disadvantage of the debtor, (e) inserting in documents of sums larger than the actual amount lent, and (f) taking of conditional sale deeds to provide against possible evasion of payment by the debtor The Royal Commission on Agriculture referred to services exacted by the moneylender in Bihar and Orissa and certain other parts of India leading to the economic servitude of the borrower Cases have been mentioned where, in consideration for advancing money by the money-lender to the cultivator, agreements are made by which produce is to be sold to the money-lender by the cultivator at a price determined for several years [1]

Regulation of Business :

Owing to these evils money-lending has been regulated and controlled In the past legislation was passed practically in every province to regulate money-lending Most of the Acts provide for the compulsory registration of money lenders and in some there is provision for licensing Penalties are provided for contravening the provisions of the Acts. The registration certificate and the licence are liable to be cancelled for specified periods on certain grounds There is provision for the regular maintenance of accounts of each debtor in prescribed form Periodical statements, annual or biannual, signed by the money-lender or his agent, showing

1 See Report of the Marketing of Groundnuts

the amount of loans outstanding, interest accrued and all transactions relating to the loan for the period are to be supplied to the debtor The debtor is not bound to acknowledge or deny the correctness of the accounts supplied to him His failure to raise any objection does not amount to an admission of correctness In most of the provinces the recording of an amount larger than the one actually lent in account books or documents is made an offence punishable with fine or imprisonment. Failure on the part of a money-lender to furnish regular statements to the debtor means that the Court may disallow interest for the period of default In many provinces, the failure to comply with the provisions regarding maintenance of accounts and furnishing statements thereof makes a moneylender liable to the cancellation of registration and his licence.

Legislation also fixes the maximum rates of interest permissible on secured or unsecured loans In some provinces the charging of compound interest has been prohibited The rates differ from province to province In a few cases, they are linked up with the Bank Rate The Law of Dundupat applies in almost all provinces In some provinces a debtor can deposit with the Court any amount payable to a creditor if the latter refuses to accept it, while in some provinces he can do so even otherwise In the United Provinces the amount to be deposited should be at least 25 per cent of the total amount due and interest usually ceases after the deposit is made

Shrinkage of Credit:

It is admitted that debt legislation has led to the shrinkage of rural credit. In most of districts of the Punjab, village money-lenders have migrated to towns after winding up their business, but agriculturists do not experience much difficulty

in getting accommodation for their *bonafide* agricultural needs. In the United Provinces it is reported that rural credit has been reduced to some extent, but credit is still available to agriculturists for productive purposes. In Madras their is evidence leading to the curtailment of credit but money-lenders have adopted devices, in many cases with the connivance of the borrowers to overcome the difficulties produced by the Act. In Bengal the Act has led to shrinkage in credit with the result that the Government has to grant Taqavi loans on a more liberal scale than before In Bihar it is reported that the small money-lenders are giving up their business with the result that the small peasants and labourers find it difficult to borrow money on reasonable terms even for their legitimate requirements. Thus Moneylenders' Acts have led to different results in different provinces, and in the absence of adequate statistical information no definite opinion can be expressed.

Suggestions Money-Lending Legislation on All India Basis

The money-lender is the most important of the agricultural credit machinery and it is not practicable to dispense with his services in the immediate future. He follows many evil practices and his charges are in many cases out of proportion to the risk involved Hence it is necessary to regulate his activities effectively, and secondly, institutional credit should be developed as alternative to the money-lender so that the latter's business may be conducted on reasonable terms and the cultivator may not suffer There should be unformity of legislation pertaining to money-lending so that the money-lender may be made an important link of the Indian money market. Without it, will not be possible for the Reserve Bank of India to exercise adequate control over money conditions in the rural

areas. For this purpose, it is necessary to have an adequate idea about capital of the money-lender. The principles governing the moneylending legislation should be uniform throughout India. It may be contended against All-India legislation that it cannot take into view the differences in the economic and financial conditions prevailing in different provinces. We may however, say that difference of details can be allowed by empowering the provincial governments to make rules which can take account of the local conditions in a suitable manner. There is a proposal for a Bank Act for India as a whole. There is no reason why there should not be moneylending legislation on an all-India basis This proposed legislation should make provision for the following facts:

Registration and Licensing .

Firstly, registration and licensing must be made compulsory for money lenders. Registration exists in many provinces even now. It will confer status on the moneylender; while licensing will secure income to provincial governments and it will be a check on the moneylenders inasmuch as the licence will be liable to be cancelled for violating the provisions of the Act. Licensing of moneylenders will also provide a machinery for ascertaining the real state of affairs regarding indebtedness and rural credit requirements, and other information necessary for devising methods of improving rural credit facilities.

Definition :

Secondly, money-lending should be carefully defined. The existing Acts define the money-lender as a person who advances loans in the regular course of business. They also specify the business or kinds of loans exempted from their operations. For example, loans advanced by Government, local

bodies, the co operative societies etc., are exempted, but in Bihar and Orissa loans from banks and registered companies and in Bihar loans from co-operative societies are not excepted Advances based on negotiable instruments other than promissory notes are exempt under the various Acts Landlords provide considerable amount of finance to their tenants and agricultural labourers and the terms of such finance are more exacting than those of the ordinary money-lenders According to the U P Banking Enquiry Committee, "the most dangerous creditor from whom a tenant can borrow is his own landlord since the latter thereby acquires a double-hold over the former." Thus the definition of money-lenders is not sufficiently comprehensive. All kinds of loans subject to interest in any shape or form, leaving those made by Government co operative societies, etc. should be regulated and controlled There will be difficulties in controlling small loans made by petty shopkeepers and landlords, but the problem must be faced It may be said that this comprehensive control will deprive the agriculturist of some of the handy forms of credit and cause hardship, but the development of institutional credit should remove this difficulty. The money-lender combines money-lending with commission agency. He can, therefore, easily avoid regulation If there is a limit placed on the maximum rate of interest which he can charge on a loan he can evade this provision by forcing the borrower to sell his produce to him on lower price than the market price Hence moneylending legislation should be accompained by regulation of marketing of agricultural produce not only inside regulated markets but also outside them In England under the English Horticultural Produce Act of 1926 all commission salesmen have been required to maintain books of account which are open to inspection and particulars of sales are to be

furnished to the consignor Thus it might be made obligatory on all agencies which buy the produce from the cultivator or sell it on his behalf to maintain proper accounts and to give vouchers and statements in prescribed forms to the seller

Regulation of Interest Rates

Thirdly the rates of interest should be regulated but these provisions have been most commonly evaded by various devices by the money-lenders The small agriculturist can afford to pay only a low rate of interest but the money-lender takes risk and his costs are high in making small loans Hence he has to charge a higher rate of interest. The rate of interest depends on factors like security the amount and period of the loan the costs of collection the business expenses, etc Hence the agricultural Finance Sub Committee suggested that in India where institutional credit is little developed and where the money lender has yet no effective competitor the authorities must need be very cautious in fixing the maximum rates of interest The maximum rate of interest should not also be uniform for all areas and all classes of people. The Committee therefore, recommended that a uniform rate of interest should not be stipulated in any legislation, but a schedule of maximum rates sufficiently detailed to meet the major variations in condition should be carefully worked out and included in each act.'[1] We generally agree with this recommendation subject to the condition that a sufficiently low rate of interest should be fixed taking into view the economic circumstances of the borrower and the lender also In countries like Australia, Denmark and Canada the Central Banking Authority has in various ways brought about a reduction in the rates of interests for the cultivators.

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1 See page 66 of the report

Inspection and Supervision

Fourthly, the Agricultural Finance Sub-Committee suggested a State inspecting and supervising agency in each province to carry out periodical inspection of the books of the money lenders to ensure the observance thereof The agency is to publish periodical reviews of the working of Debt Acts Every money-lender is to submit annual returns of his business to the agency We agree with the principles underlying this recommendation of the Committee with this difference that the moneylender should be under an obligation to submit periodical returns to the Reserve Bank of India The inspecting and supervising agency should not be a State agency but the Reserve Bank of India The Reserve Bank of India gets periodical returns from the scheduled and non-scheduled banks and the former are liable to be inspected by the Bank The submission of periodical retuns to the Reserve Bank of India will enable the Bank to know the capital investments of the money lender and to have information regarding agricultural finance The statements may be sent annually to the Reserve Bank of India in the local vernacular of the area where the money-lender resides The Bank can get them translated into English The inspection by State agency is usually associated with malpractices which will not be the case if there is inspection by the Reserve Bank of India.

Finally the audit of their accounts should be compulsory It is not necessary that they should be audited by certified auditors Money-lenders can form unions of their own to whom this business can be left. Or auditors may be appointed by the Reserve Bank of India whose expenses may be borne by the Government of India or the provincial governments.

This Act may be temporary for a period of five years in the first instance and its working may be

reviewed thereafter, then the necessary amendments may be made in the light of experiences gained

Privileges

The above legislation should be accompanied by privileges which should prove an inducement to money-lender to observe the provisions of Law. Firstly, the Reserve Bank of India should give concessions to the money-lenders on their remittances on the same scale on which they give to the co-operative societies and banks Secondly, the procedure in force for the recovery of public demands should be made available to money-lenders for recovering loans made against agricultural hundies and warehousing receipts Quick procedure is necessary in the interest of debtors and creditors alike and also for the smooth working of the banking system. The money-lender should be helped to realise his just dues so that banks may discount his agricultural paper. Thirdly banks may be persuaded to advance money to registered money-lenders on the security of their agricultural paper and the Reserve Bank of India may keep a list of approved money-lenders whose paper may be rediscounted by it. Fourthly, the benefit of the Bankers' 'Books' Evidence Act should be given to registered money-lenders Finally, a special rebate may be granted by the Reserve Bank of India on agricultural paper endorsed by such money-lenders coming through scheduled banks Legislation by itself would not be sufficient unless it is accompanied by adequate and continuous supervision of its working and systematic review of results.

Link with Joint Stock Banks :

There is another method by which the money-lender can be made a more useful agency for providing agricultural finance in India. Selected money-lenders in the rural areas may be made

their branches by important joint-stock banks The latter may finance them, exercise supervision over them and provide credit to them This can, however, be done only if the money-lender submits to reasonable conditions imposed by legislation or by joint-stock banks. The joint-stock banks may utilise the local knowledge of the money-lenders and get the co-operation of the latter.

The money-lender is the main and indispensable agency in the Indian agricultural credit system. He provides all kinds of credit The Reserve Bank of India should devise measures by which the moneylenders may become a part of the organised money market of the country, subject to the control of the Bank A consideration of these suggestions may help the Reserve Bank to have better control over the rural money market of the country. It is outside the purview of the Bank at the present time The efforts made by the Reserve Bank of India to utilise the agency of the money-lender for improving rural credit in the country will be discussed subsequently.

CHAPTER IV

THE CO-OPERATIVE MOVEMENT

History and Present Position

Co operation was officially started in 1904 on the German model in order to improve agriculture The Famine Commission of 1901 recommended "Find Raiffeisen and the problem of Indian agriculture will be solved' The Royal Commission on Indian Agriculture pointed out that 'If co-operation fails, there will fail the best hope for Indian agriculture". Thus the importance of co-operation in Indian rural economy cannot be overemphasised Although co-operation is voluntary none-the-less the view appears to be growing that when necessary co-operation might be made compulsory. 1 So far co operation has nat, however, made an adequate success in the country. At the end of 1942-43 the number of agricultural credit societies in British India was over 95 000 but efficient societies called A and B class societies formed a very small percentage. The membership of agricultural credit societies of about 31 million, oa about 1 02 per cent. of the rural population Assuming that each member represents a family of five, the co operative credit movement can be said to have touched only 5·1 per cent of the rural population Assuming that each member represents a family of five, the co operative credit movement can be said to have touched only 5·1 per cent

of the rural population In 1944 45 the loans advanced to individuals by the primary societies came to about Rs 11 81 lakhs The amount of loans outstanding against the members was Rs. 18 19 lakhs of which about Rs 7 crores or 30 per cent was overdue This indicates the small part played by the co operative movement in supplying the agricultural finance

The spread of the co operative movement would be the best solution for agricultural credit but the existing position of the movement cannot inspire much hope in that it can play a substantial part in providing agricultural finance in the near future It can however play a greater part in agricultural finance if it is properly reorganised and if it is intensively developed With this objective in view certain reforms are necessary in the movement The lines of reform are given below

Suggestions for Improvement : Liability

Many of the societies have frozen assets and have stopped functioning as a consequence It is necessary to liquefy their assets so that they may be able to resume their normal working This can be done by adjusting the claims of societies according to the repaying capacity of members The Agricultural Finance Sub Committee suggested that the credit societies should generally continue to be organised on unlimited liability basis because unlimited liability confers mutual watchfulness and co operation and inculcates a sense of collective responsibility among members but it also helps the societies to raise adequate finance which may be difficult to obtain otherwise This question was considered by the Madras Committee on Co operation which recommended the introduction of the principle of limited liability The Gadgil Committee however suggested that limited liability might be adopted if it attracted valuable elements

to the movement and a substantial part of the funds required by the societies is raised through share capital[1] The societies should finance all short-term needs of their members, and loans for current agricultural needs should be repayable at the end of the agricultural season every year Intermediate-term loans for productive purposes and for ceremonial expenditure might be advanced to the extent of the share capital and reserve fund and to the extent of the intermediate-term finance obtained from the central financing agency Such loans may ordinarily be granted for 3 years, but they may be extended up to 5 years in exceptional cases In Madras this is done and in certain cases, loans even for longer periods are granted.

Security for Advances :

The security for advances should ordinarily be personal and the creditworthiness of the members should be assessed with reference to their repaying capacity. There should, however, be a statutory charge in favour of the societies on the crop as an additional security for seasonal finance To make such a charge effective, its wilful breach should be made a criminal offence. Mortgage security should be collateral and may be justified when the loan is large in amount and the period is long.

The Central Banking Enquiry Committee referred to the delay made in granting loans and suggested the fixing of normal credit needs of members every year so that no detailed inquiries may be necessary at the time of advancing loans The system of cash credits for societies with sound management and running credits for individuals should be introduced wherever possible and loans should be advanced only as and when actually required. The disbursing of loans only on one or two days during

1 See page 48 of the Report.

the year makes co-operative finance highly inelastic and drives the cultivator to the moneylenders. The co-operative finance should, however, be so planned as to be available to each member when he actually requires it

Efforts should be made to see that loans are repaid regularly. Wilful defaults should not be tolerated Coercive processes may be resorted to in cases of wilful default. The rate of interest charged by the co-operative societies is ordinarily above 9 per cent, and in some cases it is as high as 25 per cent. This is too heavy for the agriculturists to bear. The Gadgil Committee, therefore, recomended a maximum rate of interest of 6¼ per cent for current finance For this purpose, Government subsidy was also recommended to enable small societies to bring rates of interest to this level It also suggested that the Reserve Bank of India should consider the desirability of increasing the concession granted to provincial Co-operative Banks to 2 per cent.[1]

Credit and Marketing :

The operations of credit societies should be linked up with those of marketing societies To achieve this objective, the system of controlled credit prevailing in Madras should be adopted everywhere with the necessary modifications to suit the local conditions Under this system a loan is disbursed according to needs and is recovered out of the income obtained by the application of the loan. The societies should also ensure the proper application of their loans by supplying the require ments of their members in kind and by exercising better supervision over their operations For meeting household and other needs of their members the societies should have direct relations with purchas-

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1 *See page 51 of the Report*

ing unions and consumers' stores. Where this is not possible the societies themselves may supply the requirements as far as possible. Government expenditure on the movement should increase It is too small to meet the needs of the situation In 1934, leaving out the case of the Punjab, the expenditure of the provincial governments on the movement did not exceed $\frac{1}{2}$ per cent of their revenue. Provincial governments should incur more expenditure to strengthen the movement properly A scheme of planning may be adopted by which the movement may grow to an adequate extent[1]

The expansion of the co-operative movement will provide the best solution of the problem of rural credit in the country Credit societies will render greater services and be more successful if their scope of activity is expanded The Madras Committee on Co-operation made certain important recommendations regarding the movement. It suggested the turning of unlimited liability into limited liability, an increase in the area of operation, an extension of the scope of their functions and paid management in order to make the movement serviceable in consonance with the needs of the people of the country.

State Help :

State help should be given to the movement on a much larger scale than it has been hitherto done, in order to expand rural credit. The Agricultural Finance Sub-Committee suggested the establishment of an Agricultural Credit Corporation a part of whose working capital and expenses of administration were to be provided by the State It recommended that in provinces in which the Government feel that the

1 The Co operative Planning Committee suggested that 50 per cent of the villages and 30 per cent of the rural population should be brought within the ambit of the reorganised primary societies in 10 years and a subsidy of Rs 10 crores should be given by Government in ten years

co-operative financial agencies are so strong and have such a wide scope that they could cope with the work separate corporation need not be set up. As already pointed out by us in Chapter II above it is necessary that Provincial Co-operative Banks or other central co operative financing organisation should be utilised to provide all credit facilities to the agriculturists which the Gadgil Committee intended to be provided by the proposed Agricultural Credit Corporation by the Government. A separate organisation would then be unnecessary. The Provincial Co-operative Banks can be reconstituted to take up these responsibilities. Moreover the agricultural Credit Corporation is intended to deal with the agriculturists through co operative societies where they exist. A Provincial Bank has already got this experience and will serve the purpose better. If proper planning is adopted agriculturists will be provided with institutional credit as an alternative to moneylenders credit. In this way, cultivators will be brought within the ambit of the co-operative movement. State will have to provide a good deal of the share capital of provincial co operative banks. In order that the ultimate borrowers may not have to pay more than 6¼ per cent per annum for short term loans and more than 3½ or 4 per cent per annum for long-term loans adequate financial help by the State and by the Reserve Bank of India will be indispensable.

The present is an opportune time to revitalise and reconstruct the co operative movement in our country. Rise in prices during the War and in the post-war period has benefited the cultivators. This is indicated by the recoveries made by the societies from the members. Total recoveries made in 1942-43 were greater than those made in 1941-42 and the same trend was noticeable in subsequent years. Overdues both in the case of agricultural credit societies and land mortgage banks declined consider-

ably. The deposits of co-operative societies received from members in 1944–45 came to about Rs 18.55 lakhs. In such circumstances, with a proper planning the co-operative movement should be able to serve the cultivator better. In fact, Debt legislation is driving away the moneylender from the field of rural credit. If the source of credit is not to be dried up in the future the co-operative movement should fill the gap. For this purpose a suitable rectification and consolidation will be necessary The movement was primarily started to be helpful to the cultivator in solving his credit problem , but according to the Provincial Banking Committees only 6 per cent of the finance required for the current expenses of agriculture was provided by the movement According to the Central Banking Enquiry Committee, the movement financed only a very small proportion of the needs of the cultivators ; according to the Reserve Bank of India, the position appears to have deteriorated even further during the last five years"[1] The movement, therefore, should be reconstructed in order that it may be serviceable to the cultivator in meeting his credit needs and in improving agriculture.

Reserve Bank of India's Suggestions Considered :

In its various reports and circulars issued from time to time the Reserve Bank of India has made certain suggestions to reorganise the co-operative movement In its Preliminary Report the Bank suggested that overdues and long-term loans should be separated and put on a proper footing ; that the co-operative societies should build up strong reserves by keeping an adequate margin between their borrowing and lending rates ; and that future loans should be restricted to such sums only as could be reasonably expected to be repaid out of the harvest. In the Statutory Report, 1937, it was pointed out that the co-operative movement ceased to function as an agency for supplying agricultural credit in

1. See Statutory Bport of the Reserve Bank of India.

places where the question of overdues became serious. It was, therefore, pointed out that overdues should be brought down to a level at which they could be repaid out of the proceeds of agriculture within a reasonable period of time In its Preliminary Report the Bank suggested that unless the co operative banks could put their long term loans on a business footing and separate them from their other business, the Bank will not be in a position to help them It suggested that agricultural paper, representing renewal of old loans coming through Provincial Co-operative Banks could not be discounted by the Reserve Bank

Overdues could be written off from reserves and other funds and the remainder could be spread out and recovered in easy instalments In fact the present is a suitable time when this reconstruction should be done

With regard to the other recommendation of the Reserve Bank of India that there should be an adequate margin between the borrowing and the lending rates of co operative banks, it may be said that the underlying objective was to help the utility of societies to its members Low margins are possible where the agriculturist has been prosperous and creditworthy over a long period of time, but the price of credit must indeed be high where crops are insecure as in India None the less to work successfully and be serviceable to the cultivator, the price of credit should not be high Hence the movement should be subsidised by the State

This suggestion of the Bank that loans should be restricted to amounts which could be repaid out of the harvest did not, of course imply that they should be restricted for cultivation purposes only In its Preliminary Report the Bank suggested that loans must be strictly limited to cultivation finance [1]

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1 See paragraph 40 of the Report.

This implies that expenses connected with ploughing, sowing etc., should be advanced and also money ordinarily required for maintaining the farmer's family till harvest and for purposes like the replacement of cattle or implements, provided such loans can be repaid out of the proceeds of the harvest in a normal year. The Bank laid down the ideal that if the co-operative societies are not to be mere substitutes for the moneylender they must see that the member borrows generally for productive purposes only and that other loans are reduced to the minimum.[1] The Bank also suggested that the co-operative movement must bring the whole life of the cultivator within its ambit. This idea has also been developed by the Bank in its various bulletins. It has pointed out that members must understand the aims and objectives of the societies and they should be imbued with co-operative spirit. The society must not be merely an agency for supplying finance, but it must be an influence for the alround development of agriculture and the betterment of the life of the village from every point of view.[2]

Co-operative banks must also maintain fluid resources to provide for the withdrawal of deposits. Their resources should be more fluid than those of the commercial banks because agricultural loans are granted for longer periods. Only that amount of income which is actually realised should be regarded as income and unrealised or unrealisable interest should not be added to the capital of the loan. More strict supervision must be made for setting out overdues of principal and interest in the Balance-Sheet which should specify the maturity of the loans by categories, *e. g.*, under 6 months, 6 to 12

1 See paragraph 17 of the Statutory Report of the Reserve Bank of India.

2 The same idea is embodied in the Report of the Madras Committee on Co-operation which recommended multi purpose societies on limited liability basis.

months, 1 to 2 years and over 2 years In fact, co-operative banks should be run on banking lines They should build up strong reserves. There should be closer contact between co operative and commercial banks The former should obtain credit from the latter on the security of Government paper. Above all, a progressive, efficient and well trained staff is also necessary. For this purpose, in every province there should be a College of Co-operation providing instruction to economics and commerce graduates in co-operative principles and practices in India and other countries.

Subject to the lines of reform mentioned above, the Reserve Bank of India should stand behind the co-operative movement and be prepared to grant credit facilities on the lines on which foreign central banks provide finance, giving allowance for the special conditions of our country It is indispensable that institutional credit must be developed in our country and the co-operative movement is the best agency for developing institutional credit for agriculturists The movement should, however, be properly linked to the Reserve Bank of India so that the latter may be able to make its credit policy in agricultural areas effective and may be able to pass on the benefit of its vast credit resources to the cultivator. What help the Reserve Bank of India is allowed to give to the movement under the Reserve Bank of India Act and the extent to which this financial help has been given in the past as also the policy that the Bank should pursue for the future will be discussed subsequently.

CHAPTER V

OTHER IMPORTANT AGRICULTURAL CREDIT AGENCIES IN INDIA

The land mortgage banks the indigenous banker the commercial banks and the loan offices of Bengal are other agencies engaged in providing agricultural credit in our country In this chapter a brief reference is made to the nature of their organisation and operations to estimate the part played by them in agricultural credit and to see the lines on which financial link between them and the central bank of the country can be established to the advantage of Indian agriculture The indigenous banker may be an individual or private firm receiving deposits and dealing in hundis or lending money Ordinarily he has no direct relation with the cultivator, because he finances trade and industry primarily He may finance agriculture through the local Sahukar or moneylender Indigenous bankers consist of Marwari Shroffs Multanis Chettiars and others This class sticks to its hereditary methods of business and is businesslike, frugal and shrewd and finances most of the inland trade and industries and also plays indirectly considerable part in supplying agricultural credit[1] In the sphere of village and agricultural finance by far the largest credit facilities are provided by shroffs who are spread over the whole country They are, in fact, the pivot of the Indian banking system Their importance cannot be overemphasised They provide marketing finance for agriculture and in order that they

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1 See Statutory Report of the Reserve Bank of India 1937 page 42

may be made more helpful in the agricultural credit machinery of the country they should be linked with the central banking system of India. The way in which this can be done will be discussed subsequently

Land Mortgage Banks : Their Classification :

Long term finance for agriculture should usually be supplied by a separate agency which is a land mortgage bank In foreign countries such banks have been organised to provide long-term credit for agriculture They are of various types and differ widely in their features in different countries They were evolved not in response to any definite economic theories but to provide solutions for local conditions. They may be classified in different ways on different principles Broadly they may be co-operative, non-co-operative or quasi-co-operative. The Prussian Farm Mortgage Mutual Credit Associations belong to the first category. They are associations of borrowers, having no capital They do not aim at profit and try to keep the rate of interest low Each member pays a small entrance fee to meet the necessary expenses Mortgage bonds are issued to obtain capital and these bonds are quoted on the Exchanges In Germany they are called Land Schaften and are combined into a central Land Schaft which is a central co-operative organisation The Federal Farm Loan Banks of the United States of America also belong to this type The non co-operative type is represented by the continental system The Agricultural Bank of Egypt the Credit Foncier de-France, etc are based on this model They work for profit and declare dividends The State exercises control over their operations so that there may be no hardship to borrowers or to debenture-holders There are also institutions which combine co-operative and commercial ideals in different proportions and they are of a quasi co-operative character They have

share capital and limited liability and their membership is open to borrowers and non-borrowers both. The Hungarain Land Mortgage Institute for large landowners and the National Small Holdings Land Mortgage Institutes for small owners as also the long-term credit organisations in Norway and other countries are examples.[1] These banks provide loans for repaying old debts and for land improvements on mortgage security. They have specialised machinery for the valuation of land and they raise funds for long periods of time by floating debentures.

In India land mortgage banks are in existence on the co-operative model. A beginning in this direction was made when the Central Land Mortgage Bank was started in Madras on co-operative lines. Afterwards they grew up in other places also. In Madras and Bombay, they were established for financing and co ordinating the working of primary banks, but in the Central Provinces and Bengal separate departments of the Provincial Co-operative Banks are looking after this work. In Orissa the Provincial Land Mortgage Bank finances the agriculturists direct through its branches They have not made adequate progress in our country. Except in Madras they are not adequately developed At the close of 1942 43 there were 273 land mortgage banks in India of which 120 were in Madras. In 1944-45 their number went up to 289. In 1943-44 debentures outstanding and the loans due from individual members came to Rs. 3 63 crores, respectively, of which the share of Madras alone was Rs. 2.82 crores and Rs 2.30 crores, respectively. This development is inadequate in consonance with the needs of long-term finance for Indian agriculture.

The Provincial Governments are helping these

1. For a detailed account of these types see Rural Credits by Herrick, Place of Rural Credits by Morman and the Indian Central Banking Enquiry Committee Report. Also See Appendix.

banks by guaranteeing their debentures in respect of principal and interest. They also supply them with free services of valuation officers and other departmental officers and grant them subsidies in some cases This policy must continue and if possible and necessary, Government should be more liberal in this connection Government subsidies are also granted in other countries The case of England may be mentioned on the point The Agricultural Mortgage Corporation of London issues debentures bearing 5 per cent interest but it itself charges only 4 per cent on loans This is due to the subsidies granted to the Corporation by the State which in 1943 44 amounted to £ 50,000 In many other countries also interest-free advances are placed at the disposal of such institutions [1] A Bill was before Parliament in June 1944 to extend financial assistance to the Corporation so that it might be able to reduce its rates of interest to 3½ per cent A similar ideal must be maintained in our country also so that long term finance may be made available at 4 to 4½ per cent Here it may be pointed out that the Mortgage Bank Department of the Commonwealth Bank of Australia loans up to 20 years at 4 per cent per annum and for 21 to 41 years at 4½ per cent per annum In New Zealand the State Advances Corporation was set up in 1935 It is a State owned institution having branches in 21 district centres Its loans on mortgage together with interest amounted to £ 458 18 lakhs in 1942 These loans are given on the long term amortisation system and the rate of interest has been 4½ per cent for several years [2] In Norway an institution for granting of working credits was established for granting loans to small farmers' working Credits Associations. The interest charged does not exceed the average interest on the borrowings of the institution and in the beginning

1 For details see Chapter

2 See Annual Report of the Corporation for the year ended 31st March 1943.

it was limited to 4 per cent. The State makes up the difference between borrowings and loans granted and its administrative expenses. The National Agricultural Credit Institute of Rumania was founded in 1937 with a capital of 1,000 million Lei, half of which was subscribed by the State and the other half by other institutions including the National Bank This institute was to receive annually an amount of 1,000 million Lei for 20 years and its rate of interest is to be kept at a low level

Their Operations in India :

In India land mortgage banks have so far been making advances almost entirely for redeeming old debts In 1937, an inquiry made by the Agricultural Credit Department of the Reserve Bank of India into the working of land mortgage banks showed that loans for liquidation of old debts formed 98 6 per cent of the total of advances as against .38 per cent advanced for land improvement Of course, improvement in the economic condition of the cultivator cannot be made without removing past indebtedness ; but this alone cannot be helpful and it is, therefore, necessary to develop the business of land improvement The maximum amount that can be lent to a member is Rs 10,000 and the limit in some cases has been reduced to Rs. 5,000. There are minimum limits also at about Rs 300. Loans are made only to agriculturists against the security of first mortgage of agricultural land of at least twice the value and are repayable in 20 years at the most in equated annual instalments, the borrowers having the option to make repayments earlier. The repaying capacity of the borrower is taken into account in sanctioning loans. The rate at which loans are advanced by the primary banks vary between 6 and 7½ per cent. per annum while in Assam the usual rate of interest is 10 per cent This is higher than it ought to be. Funds are

raised mainly by debentures and also by shares Borrowers are required to subscribe to the share capital an amount equal to 5 per cent of the borrowings Debentures are guaranteed by Government in respect of principal and interest and the period of their maturity varies from 20 to 25 years They are irredeemable for the first 10 years but can be redeemed at any time afterwards at the option of the banks The banks are required to *constitute regular sinking funds for redeemable* debentures

Government Help :

The development of land mortgage banks has been encouraged by the Government Their debentures have been guaranteed and subsidies granted in the initial stages to meet deficits In Orissa the Government have taken up a small part of share capital Exemptions have also been granted to them from stamp duty and registration fees regarding documents to be executed by the borrowers The Government exercises control over them The Registrar of Co operative Societies is usually the trustee appointed by Government to secure the fulfilment of the obligations of the banks to the debenture holders The valuation of land is done by Government officers whose services are provided free to the banks in many cases In certain provinces Land Mortgage Bank Acts have been passed and power has been conferred on these banks for the speedy recovery of arrears from the defaulters as recommended by the Indian Central Banking Enquiry Committee

Necessity of Expansion :

The number of land mortgage banks should be considerably increased in our country Vast funds must be required for land improvement in a planned system of agricultural economy and planning of

agriculture is indispensable to increase the yield from agriculture, for India must be converted from a deficit to a surplus country in respect of food commodities Hence services of land mortgage banks will be required to a much larger extent. Secondly, fundamental reforms in land tenure must bemade to improve the condition of Indian agriculture. This means the abolition of Zamindari system which now is an admitted fact. There are Bills pending before provincial legislatures to abolish Zamindari. The most efficacious substitute for the Zamindari system would be the peasant-proprietorship system which will provide incentive to the cultivator to make improvements in land. It is also admitted that the abolition of Zamindari is to be subject to the payment of reasonable compensation. Roughly 15 to 20 times the net rental receipts retained annually by the Zamindar as his share after paying land revenue to the State may be regarded as the fair scale of compensation. This amount has to be paid to the dispossessed land-owner immediately. The cultivator will like to make the payment to the land-owner and realise the money gradually from the proprietor who will pledge his land as security with the Bank. They will collect funds by selling debentures which must be guaranteed by the State and which must bear a reasonable rate of interest of not more than 3 to 3½ per cent. They should advance money on behalf of the cultivators at Zamindari abolition a low rate of interest. Such banks must be started in large numbers They must be subsidised by the State and a large part of their initial expenses may have to be borne by the State. Unless this is done and unless interest-free balances are placed at their disposal by the State, this objective cannot be achieved. In this way a network of co-operative land mortgage banks should be set up in our country primarily to make loans for land improvement and to enable the constitution of

economic holdings to be created, and also to constitute peasant proprietorship in place of the existing Zamindari system *The type of help that* can be granted by the Reserve Bank of India to such banks is to be discussed in a subsequent chapter Wherever Land Alienation Acts are in force, they should be suitably amended, and summary powers for recovery of arrears must be conferred upon them

Commercial Banks :

The part played by joint stock banks in India is very small Out of about 2500 towns having a population of 5000 or more in India only 140 had each a banking office in 1916 and this number increased to 514 in 1936 On the 30th June, 1945, the total number of offices of the scheduled banks including head offices, branches pay offices, etc., was 2715, while the total number of non-scheduled banks was 613 at the end of December, 1944. The total demand and time liabilities of scheduled banks stood at Rs 868 58 crores on the 29th June, 1945 and the advances made by them stood at Rs 279 74 crores The total demand and time liabilities of the non scheduled banks stood at Rs 53 13 crores at the end of 1944 No complete data regarding advances made by these banks against agricultural produce are available Figures were collected by the Agricultural Credit Department of the Reserve Bank of India for 39 scheduled banks in respect of such advances They indicated that on 31st December, 1942, 38 banks had made advances to the extent of Rs. 22 17 crores against security of agricultural produce, while the advances of one came to Rs 11 58 crores on the 31st December, 1943 They were made against food and money crops and mostly against cotton The rate of interest varied from a minimum of 2½ per cent in a few cases up to a maximum of 10 per cent, the usual rate being 6 per cent [1]

1 See Report of the Agricultural Finance Sub Committee page 56

It is sometimes suggested that commercial banks should be encouraged to develop their agricultural business by giving them a first charge on crops and on the farming stock. This will, however, stop finance from other sources and can be justified only if these banks can supply adequate finance to the agriculturists They are, however, unsuited for this purpose Even in other countries they have not been able to cater for all the credit needs for agirculture Hence agricultural charges should not be created in favour of commercial banks. It is also suggested that commercial banks should be allowed to make advances against the security of title deeds. Commercial banks will not, however, be attracted by this facility Hence this should not be done They can be helpful in providing marketing finance In this connection the scope of their business can be increased considerably by improving the arrangements for the marketing of crops by (1) the grading and standardisation of staples and of contracts, (2) proper storage facilities, and (3) the creation of properly regulated local as well as forward markets The improvement of marketing facilities will reduce the cost of marketing to the grower and ensure him a fair price. It will also encourage commercial banks to take a greater part in financing the sale of agricultural produce.

As pointed out by the Indian Central Banking Enquiry Committee the uneconomic nature of agricultural holdings in India, the slenderness of the security that the agriculturists can offer and other causes account for the fact that joint stock banks have not provided any substantial amount of rural credit in India. If they liberally extend the system of financing against precious metals including ornaments the well to do cultivators might come to them. It is however, in respect of marketing finance that commercial banks can provide agricultural credit facilities. The Reserve Bank of India

recommended that commercial banks can be helpful in financing the movement and marketing of crops by making short-term advances against produce provided regulation of markets is done There is considerable scope for an increase in the financial support to be given by commercial banks to moneylenders, indigenous bankers and co-operative banks if these agencies are organised along proper lines The help to be rendered by the Reserve Bank of India will be considered subsequently

Loan Offices of Bengal:

The Loan Offices play an important part in financing agriculture in Bengal On the 31st March, 1931, there were 1008 loan offices and in 1929 most offices with a working capital of Rs 50,000 or less had no reserve fund worth the name[1] Their working capital was estimated at Rs 9 crores but about two-thirds of them had a total working capital of less than a lakh of rupees According to the Central Banking Enquiry Committee the percentage of reserve fund to capital was very low in many of them They obtained their capital by deposits which they received for about three years or so The rate of interest on deposits received by them varied from 4 to 9 per cent In some cases it varied from 10 to 15 per cent and in one case 24 per cent was paid to receive deposits[2] In these circumstances it is clear that their rates of interest are bound to be high The larger offices deal mainly with Zamindars substantial tenure holders and the middle class and the small offices deal with the small tenure holders and cultivators They make advances against personal security and on the mortgage of land and buildings Their rates vary from 9 to 15 per cent for

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1 See Paragraph 442 Bengal Prov nc al Bank ng Enquiry Committee Report

2 *See Para 254 Ind an Cent al Bank g Enq ry Comm ttee Report*

a mortgage and from 15 to 25 per cent for personal security, with 37½ for small loans These offices have not been beneficial to the cultivators. They have not been a benefit to the Zamindars and many of them proved a snare.[1] During the depression they were adversely affected and agricultural finance was paralysed In the case of Faridpur Loan Office the loans amounted to Rs 3 39 lakhs in 1933–34 Reserves were completely wiped out in many cases Many of them applied for sanction under the Indian Companies Act for compromise with their depositors The compromise provided for a reduction in interest rates on deposits to less than 4 per cent and for gradual repayment of the amount in 5 to 10 years Government assistance was requested in the from of advances against the land mortgaged with them The provincial and Central Banking Enquiry Commitees made certain recommendations to improve their condition. Mr N. R Sarkar suggested that an apex Corporation should be started to finance Loan Offices and help them to liquefy their assets Their business should be regulated and they should either be governed by the Banking Companies Act or a separate Act applying to them should be passed, governing their constitution, capital, reserve funds, operations and the like Only when they are properly organised will they be in a position to be of service to agricultural industry. The Act, in the first instance may be a temporary measure for five years and thereafter its working may be reviewed It is then that they can come within the ambit of the Reserve Bank of India

Government Finance for Agriculture :

The Government has also been providing financial assistance to the cultivator in the form of taccavi loans. In the pre-British period, the State

1 See page 45 Darling's Report on the Constitution of the Reserve Bank of India, Appendix 5

was helping the ryots financially in times of floods and famine. A number of Acts were passed in 1871 1876 and 1879 and ultimately the Land Improvement Loans Act of 1883 and the Agriculturists Loans Act of 1884 were passed on the recommendations of the Famine Commission of 1889 Under the former Act long term loans are granted up to a maximum period of 35 years for land improvement, but in actual practice the loans are restricted to 20 years and the rate of interest is determined by that at which public loans are floated at the time The amount of finance provided is very small. In 1937 38 only Rs 75½ lakhs were given under both the Acts The Royal Commission on Indian Agriculture found their working satisfactory and suggested that steps should be taken to make the benefits available under them more widely known to the cultivators According to the Central Banking Enquiry Committee their working leaves much room for improvement[1] These Acts have not been of much benefit because of delays in granting applications and the existence of illegal gratifications The U P Banking Enquiry Committee estimated the effective cost of a taccavi loan at 25 per cent

Agency for Distribution :

It is necessary that the agency for distributing these loans should be changed The Indian Central Banking Enquiry Committee pointed out that they had no objection to Government using the co-operative societies as mere agents for distribution, but certain Provincial Banking Committees did not favour this suggestion These funds should be dis

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1 See paragraph 237 of the Report. Also see Mr Sher Jang Khan's Article in the proceedings of the Fourth Conference of the Indian Society of Agricultural Economic Bombay According to him the total outstanding amount under the Act was less than a crore of rupees of which the overdue was about Rs 13 lakhs and the amount advanced in 1939 40 was about Rs. 5 lakhs.

bursed either through the Reserve Bank of India by entrusting funds directly to the Agricultural Credit Department of the Bank or by opening a Mortgage Bank Department on the Australian model The funds disbursed under the Act of 1883 may be placed at the disposal of the latte rDepartment and those under the Act of 1884 should be given over through the Agricultural Credit Department when and if it is directly entrusted with funds Or, the land mortgage banks and co operative societies should disburse these funds Then alone these funds will reach the cultivator properly and the Reserve Bank of India will be able to exercise a more effective control over the money market.

The above discussion indicates the part that various agricultural credit agencies are playing in India in providing agricultural finance When proper reforms are introduced in them, it will be possible for the Reserve Bank of India to exercise control over them and to help agriculture by providing adequate financial facilities It is necessary that these agencies should come into touch with the Bank and at the same time rates of interest must be reduced to proper levels The help that the Reserve Bank of India has rendered and is allowed under the Act to render and that it should render in the future will be discussed in the following chapter

CHAPTER VI

REORGANISATION OF AGRICULTURAL FINANCIAL SYSTEM IN INDIA

Necessity of Structural Changes :

Agricultural financial system in India requires to be reconstructed on sound lines in order that it may meet the credit needs of agriculture in a proper manner The structure of agricultural finance should be reorganised to put Indian rural economy on a sound footing and to make agriculture an economic preposition for the cultivator In this connection, certain important points are to be borne in mind.

Trends in Agricultural Debt :

First the existing position of agricultural debt and the future trends therein must be properly appraised After the Banking Enquiry Committee no all-India survey of agricultural debt has been made. The war may have reduced it but the position has to be ascertained in its proper perspective The Agricultural Finance Sub Committee remarked in its Report that the determination of the total volume of present debt was not an important preliminary for the work of the Committee' and it was merely satisfied by broadly indicating the nature of the rural debt situation in the country

Reduction Of Debt :

Secondly, the existing agricultural debt should be reduced to a level which is well within the repay-

ing capacity of the cultivator. A general adjustment of the debt burden is necessary to raise a new structure of agricultural finance in which borrowed funds will be utilised for productive purposes and the economic solvency of the cultivator will be ensured. The present is the most suitable time for it when the cultivator in the past has made profits and when he is in a position to clear off his debts. In this connection the debts of cultivators with proprietary rights in land should be reduced to 50 per cent of the value of the landed property, while in other cases they may be reduced to a level which is well within their repaying capacity. The burden of past debts acts as a great impediment in the way of the improvement of the economic condition of the cultivator and it binds him permanently to the moneylender which is to his disadvantage. This situation must not be allowed to exist.

Reduction in Interest :

Thirdly, whatever the agency for providing agricultural finance may be, it is necessary that the rate of interest should be considerably reduced. In England the Agricultural Mortgage Corporation of London charges only 4 per cent interest on its long-term loans while itself pays 4½ per cent to 5 per cent on debentures and recently it reduced its rate to 3½ per cent. This was possible because of the subsidies granted by the State amounting to £ 50,000 in 1943-44. In America the rate of interest of the Federal Farm Mortgage Corporation was 4 per cent up to June 1945; while the Federal Intermediate Credit Banks provide discounting facilities at 1½ per cent to enable the financing institutions borrowing from them to grant loans to farmer-borrowers at a rate not exceeding 4½ per cent.[1] The rates of interest charged by the State Rural and Agricultural banks

1 See the 13th Annual Report of the Farm Credit Administration for 1944 45

and corresponding institution vary between 3¾ and 4½ per cent in Australia The maximum rate prescribed by pastoral finance companies at present (1947) is 6 per cent. In Demark between 1940 and 1945 the rate of interest on long-term mortgage credit was reduced to 3 6 per cent because of the monetary policy of the central bank The rates of interest for current finance in India should be reduced to 6¼ per cent, while those for development finance should be reduced to 3½ to 4 per cent[1] At present Indian cultivators do not get loans at fair interest This is evident from the rates of interest charged by co operative societies In 1944-45 the most usual lending rate of interest was 7¼ per cent for Madras 8⅝ per cent for Bombay, 12½ per cent for Bengal 9 to 12 per cent for the United Provinces and 6 to 25 per cent for Bihar and Orissa The rates charged by moneylenders, though regulated by legislation in theory are much higher in practice for they follow various devices to get over the provisions of the law

Agency for Loans :

Fourthly, there is the question of the agency to grant loans to the agriculturists At present the part played by the moneylender in financing agriculture *is most predominant but this system of* finance is very costly The Central Banking Enquiry Committee estimated the total agricultural debt of India at Rs 900 crores of which Rs 500 crores was long term debt and Rs 400 crores was short term debt The resources of agencies other than the moneylender are much too inadequate to meet the needs of the cultivators This is evident from the fact that during 1944 45 the total number of agricultural credit societies was 136 358. Their working capital was Rs 30¼ crores During the

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1 These limits have been considered as proper by the Agricultural Finance Sub Committee *vide* its Report p 44

year they advanced loans amounting to about Rs 15 crores The number of non-agricultural societies was about 22,000 and their working capital was about Rs 50 crores Thus the total working capital of agricultural and non-agricultural societies came to about Rs. 80 crores. This is the amount of current agricultural finance which co-operative societies can provide for agriculture and allied industries During the same year the number of land mortgage banks in India including the States was 289 with a working capital of about Rs 8 crores They obtained their funds mostly from debentures which stood during the year at Rs 3 74,000. Thus land mortgage banks cannot provide long-term finance beyond the amount of their working capital which amounts to Rs. 8 crores[1] The joint stock banks provide only marketing finance to the extent of slightly over Rs 22 crores (1942) The usual rate of interest charged was 6 per cent though it varied from 2½ per cent to 10 per cent[2]

It is thus clear that the moneylender provides the bulk of finance, while other credit agencies do not have adequate resources to meet the needs of the agriculturists Of the existing credit agencies the co-operative movement can be expected to play a larger part in providing agricultural finance, provided it is reconstructed and revitalised. It has been in existence now for about half century, but it has touched hardly a fringe of the agricultural population It is true in some provinces like Bombay and Madras it has made adequate progress, but in others, like Bihar and Orissa, it is in a very bad condition *Joint stock banks can only provide* marketing finance and the way in which the part played by them can be improved will be suggested in a subsequent chapter

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1 See Statistical Statements relating to the Co operative Movement in India for the years 1943 44 and 1944 45 published in 1947

2 *See Report of the Agricultural Finance Sub Committee page 56*

Provincial Agricultural Credit Corporations :

The Agricultural Finance Sub-Committee suggested the setting up of the Provincial Agricultural Credit Corporations as alternative agencies of credit in different provinces According to the Committee the alternative credit agency must be an autonomous public corporation established by the State and operating under general official supervision and direction, but whose day to day working and normal business transactions are largely conducted on independent basis ? [1] Half of the capital of such corporation is to be provided by provincial governments and the rest by institutional investors The affairs of such a corporation are to be managed by executive officers appointed by the provincial governments and its policies should be framed by a board consisting mainly of nominees of government and representatives of other shareholders Such corporations will deal with any individual agricultural producer applying for loan The advantages claimed for such a corporation are that the cost of finance is not likely to be larger than that of private or co-operative finance It will have an assured volume of work which will be greater than available normally to a private or co-operative concern. It will provide long term intermediate-term and even short term finance to the cultivators, but in the less developed tracts a State Corporation may find it difficult to meet the needs of short-term finance of the smaller cultivators The solution for this difficulty is that such cultivators should be induced to form themselves into co-operative credit societies financed by the co operative central financing agency or if need be by the State Corporation. If co-operative credit societies in such areas cannot be formed some kind of borrowers organisations will have to be formed

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1 See page 36 of the Report.

as a link between the local agency of a State corporation and the agriculturists. such borrowers' groups would collect applications for loans and also the required information for borrowers in the locality concerned and transmit them to the lending agency The Committee suggested that the State was to give subsidies and other help in order to meet the cost of administration and collection of loans, particularly in the less-developed regions.

Co-operatives as Alternative Agency :

The existing co-operative organisation cannot serve as the general alternative agency to the money-lender for a number of reasons First, co-operative banking organisations are not strong in provinces like Bihar and Orissa [1] Secondly, the co-*operative organisations are to be autonomous bodies* managed by members themselves They cannot be used, therefore, as instruments for giving effect for government policy without interfering with their autonomy Thirdly, co-operative societies can provide agricultural credit facilities only for their members and not for others Fourthly, they are not so developed and widespread as to lead to any substantial duplication of efforts as a result of the creation of State agricultural banks.

The Committee did not intend that the Agricultural Credit Corporation should take the place of co-operative banking, where the latter is adequately developed. It, however, suggested that in provinces like Orissa where there is no provincial co operative bank, one need not be established The Agricultural Credit Corporation can finance the co-operative societies in such provinces The Corporation may also finance co-operative societies

1 See the Report of Sir M L Darling on Co operative Movement in India submitted in 1934

where adequate higher organisation does not exist In provinces where normal co operative banking and co operative land mortgage banks are adequately developed, the Agricultural Credit Corporation with its branches will be a third system Care should be taken to provide for co ordination of all the agencies and for preventing overlapping of areas in provinces where co-operative banking and land mortgage banks are developed adequately The Committee further pointed out that in provinces where government feels that co operative financing agencies are so strong that these can do all the work a separate State corporation need not be set up provided 'that some means are found for making finance through co-operatives available to all credit-worthy borrowers' In such cases the suggestion of the Committee is that the co-operative structure should get the same type of support as recommended for the Agricultural Credit Corporation

State Institutions in Foreign Countries :

In certain other countries like Egypt, South Africa and in the United States of America the apex banks providing finance to co-operative societies are virtually State institutions In New Zealand the State Advance Corporation grants long-term credits and the Rural Intermediate Credit Board set up under the Act of 1927 advances funds to individual associations and co operative societies and discounts promissory notes. The government advances funds and help it in floating debentures Rural intermediate credit associations can be set up under the Act, consisting of 20 or more persons engaged in agriculture They borrow money from the Board and lend it to members on approved securities for a maximum period of five years up to the maximum amount of £ 2,000 to a person or ten times the value of shares held, whichever less The Board can also make loans to the co operative

societies. In the United States of America the Federal Credit Administration was set up in 1933, under which the country has been divided into 12 districts for purposes of agricultural credit and each district has four institutions in the establishment of which the State participated. The original capital of the Federal Farm Mortgage Corporation was 200 million dollars which was provided by the State. It groups together all local agricultural associations, lending money on mortgage to farmers. The banks for co-operatives are also State-aided and in 1945-46 they provided credit to over 1,000 co-operative associations of over 375 million dollars at 4 per cent interest. The Federal Intermediate Credit Bank and the Production Credit Corporation grant intermediate-term and short-term loans. In 1946 the former granted loans amounting to over 900 million dollars. The paid-up capital of the 12 Federal Intermediate Banks was 60 million dollars and all the capital stock is owned by the United States' Government. There is the National Credit Committee associated with the Farm Credit Administration. The Governor of the Administration is the Chairman of the Committee. This Committee is represented by leading farm organisations, other agricultural credit agencies, the Federal Reserve Banking System and co-operative agencies connected with agricultural finance and it discusses farm mortgage situation and attends to other allied problems. Thus in many other countries State organisations exist to finance various types of co-operative societies.

In Bulgaria, the State makes advances to agricultural co-operative societies through the Agricultural and Co-operative Bank. It set up an Amortisation Fund in 1934 to finance the settlement of the amount due to creditors. In Egypt, the Credit Hypothecaire Agricole de' Egypt was founded by Egyptian Government in 1932 to give long-term

loans to small land owners. The Egyptian Government also came to the help of the borrowers in 1933 by repaying to the Land Bank two-thirds of the arrears subsequent to 1928, the remaining one-half being repayable in 35 years at 6 per cent. In Germany, the Retanbank was set up with a capital of Rm 500 million to provide mortgage credits. In Greece, there is the State founded Agricultural Bank as the apex credit bank It controls the working of the primary credit co-operatives and the unions In Turkey, the Agricultural Bank was reorganised between 1923 and 1936 under the direction and control of the State, and according to the Law of 1936 it acquired the character of autonomous State institution distributing credit to agriculturists In Yugoslavia, the Agrarian Bank was created in 1929 with a capital of 700 million dinars, 200 million of which were subscribed by the State to grant loans on favourable terms to agriculturists It is not a State bank, but the State controls it closely and appoints some of its directors including the Chairman of the Board. It grants short and long term loans direct to agriculturists who are not members of a credit co-operative society and to agricultural associations It was entrusted with the financial liquidation of agrarian reform. It was empowered to issue 4 per cent bonds with a State guarantee, repayable in 30 years, to pay compensation on behalf of agriculturists to expropriated landowners Such agriculturists make repayment to the Agrarian Bank in 30 years at 5 per cent In Belgium, the National Institute of Agricultural Credits was set up in 193/ to grant long-term loans. Its registered capital was 30 million francs, of which half was subscribed by the State. It is also authorised to issue bonds up to a certain amount under State guarantee In Colombia, there is a central institution called the Agrarian Credit Fund, 85 per cent of whose capital is subscribed by State

which also appoints its managers In Finland, the Mortgage Loan Bank for Agricultural Undertakings is a State bank which grants long-term loans. The State also makes budgetary appropriations to provide agriculturists with loans at reduced rates for land improvement, drainage etc and special funds have been set apart to improve methods of production and to carry out agricultural reform The State also guarantees loans contracted by the Central Bank of the rural banks the mortgage society and the mortgage loans bank for agricultural undertakings It also assumes liability for a part of the interest rates of long-term loans to agriculturists In Italy, the National Consortium for Agricultural Improvement Credit is a public institution and was created for land improvements Its registered capital of over 282 million Lira was partly subscribed by the State The State also shares up to 2½ per cent in the payment of interest on loans advanced by it In Norway the Mortgage Bank and Small holdings Bank are State institutions and they grant credits to agriculturists In Norway, among others there exists a Norwegian State Bank for small propertyowners and a Farmers' Credit Institution to grant long-term loans for agriculture They get their working capital largely by issues of State-guaranteed long-term bonds In Switzerland the financial requirements of agriculture are partly covered through the intermediary of Raiffeisan Banks and partly through Cantonal Banks The latter are guaranteed by the State and are specialising in the granting of mortgages which are not restricted to agriculture only In Sweden there are several kinds of funds to provide loans for agriculture which are administered by different governmental institutions In Ireland, the Agricultural Credit Corporation, of which the greater part of the capital is owned by the State, provides medium and long term loans for agriculture. Legislation is in course of enactment

whereby the whole of the capital of the Corporation will be held by State In England also the State provides funds for the Agricultural Mortgage Corporation by means of advances up to a total of £ 750 000. The funds of the Corporation carry a Government guarantee In Denmark in August 1945 a price agreement was concluded with Great Britain providing for prices of the most important agricultural products (butter bacon and eggs) declining according to certain scale, In consequence of this agreement the Danish Government was put to the necessity of granting subsidies to the export of agricultural products In the New Anglo-Danish agreements concluded in July 1946 and February 1947 stipulating some higher prices of the above mentioned produce the subsidy policy has necessarily been continued Besides, certain State loans are also made available for agriculturists

In Australia in three States Rural Banks have been set up by the State Governments Each such bank is controlled by Commissioners appointed by the State Governments Their funds are mainly provided by the issue of debentures guaranteed by the State or by advances made by the State and to a small extent by deposits from the public In one State, the function of lending to primary producers is performed by a department of the State Savings Bank In two States the corresponding institutions are in effect, State Government Departments. Some of the State Governments have set up departments to lend money to returned soldiers and others for the purpose of establishing and maintaining them on the land The rates of interest charged by these banks vary between 3½ per cent and 4½ per cent per annum[1]

It will be thus clear that the State plays a

[1] For details see Chapter III of the Report of the Royal Commission on Monetary and Banking Systems in Australia published in 1937

great part in organising agricultural credit. In some countries agricultural banks have been organised directly by Government, while in others, the State makes advances or contributes a part of the capital of agricultural banks or it guarantees interest on bonds issued by agricultural credit institutions In certain other countries, there are departments of the State granting agricultural credit while in others, economically backward areas and communities are financed by State department as is done by the Farm Security Administration in America

Arguments against Agricultural Credit Corporations :

Thus as the above account shows, in foreign countries there are State institutions working side by side with co-operative societies and in many cases they provide the main agricultural credit system There is therefore, precedent in foreign countries for the recommendation of the Agricultural Finance Sub-Committee for the establishment of State-aided agricultural credit corporations to supplement the efforts of other agricultural credit agencies in our country to provide credit facilities for agriculturists. There are, however, certain arguments against the establishment of the agricultural credit corporations in different provinces The setting up of State subsidised corporations would injure the interests of the co-operative system.[1] The Nanavati Committee appointed in 1947 came to the conclusion that " the existing co operative agency can, with suitable reorganisation and State-aid, carry out the work of the agricultural credit corporations and in view of this, it is not necessary to start an Agricultural Credit Corporation. According to the Committee, it is doubtful if such a corporation can be immediately started It may take a

1 See proceedings of the All India Co operative Conference held at Lucknow in 1947 which opposed this recommendation

long time, Moreover, in the opinion of the Committee, the co-operative movement should be strengthened in place of the setting up of a new parallel structure. In a province like Bombay the co-operative movement is adequately developed and is serving a large proportion of the creditworthy cultivators There are about 5,000 rural credit societies in Bombay province and the central agencies have many branches. Also there is a well-developed marketing organisation with a provincial marketing society and about 200 purchase and sale unions. In view of these facts, the Nanavati Committee does not favour the setting up of an Agricultural Credit Corporation It also points out that for meeting the needs of scattered individuals the branches of the Agricultural Credit Corporation cannot prove a better agency The Corporation will not have experience of work and will be lacking in local contact with non-officials Moreover, the establishment of a rival agency with government support will impede the growth of the co-operative credit movement When cultivators can obtain finance at lower rates from the State subsidised Corporation, they will not prefer to deal with co operative societies. This competition will be unsafe because it will have the use of government funds free of interest. The resources of the country will therefore, be frittered away

Position of Co-operative Movement :

It may be pointed out that simply because co-operative societies have already been in existence for some time is no ground why no superior rival agency should be set up The point is whether the co-operative movement can attain such a position in the visible future as to be able to confer on the rural population all benefits claimed for an Agricultural Credit Corporation. We may point out that in provinces like Bombay and Madras, where

the co operative movement is adequately developed and where with adequate government support of the type recommended for the Agricultural Credit Corporation it can further develop, it may not be necessary to start a rival agency In provinces like Bihar Orissa and elsewhere when the co operative movement is in a very bad condition there is every reason for starting an Agricultural Credit Corporation on the lines suggested by the Agricultural Finance Sub Committee In fact this is what the Gadgil Committee themselves have suggested when they write that in such cases there would be no objection if a separate State corporation is not set up provided however that some means are found for making finance through co operatives available to all creditworthy borrowers [1]

In fact the possibility of granting the same type of help which is suggested by the Gadgil Committee for Agricultural Credit Corporation may be given to Provincial Co operative Banks and they may work along the lines suggested by the Committee for Agricultural Credit Corporation The existing co operative societies may be utilised as the branches of these banks thus maintaining the autonomous character of the co-operative movement and at the same time making the resources of the State available to the co-operative movement to an adequate extent.

Finance will also be required to meet emergencies like famine flood or any other calamity There are large areas where failure of agricultural production takes place periodically Such emergencies are at present met by Famine Relief Balanced economy should be introduced in areas where distress conditions are chronic as a result of famines or floods Long range programmes of economic development should be prepared for such areas In each province for such areas, an administrative machinery on the

1 See page 43 of the Report.

model of the Farm Security Administration in the U S of America should be set up In the U S A this Administration gives help to the needy farmers in various ways. In some States in America the Administration is financing almost one-half of the farm population. A programme of relief and rehabilitation should be framed, involving financial and technical assistance The State will have to make grants for such a programme and special subsidies may have to be provided to meet the needs of the situation State-aided agricultural credit corporations can provide the necessary finance for such purposes. Normal credit agencies are unable to cope with such conditions Hence special State-aided financial institutions are needed for such purposes. A part of the cumulative agricultural debt is due to such conditions, and when special provision is made for them, the working of normal agricultural credit machinery will be facilitated.

Whatever the agency or nature of rural finance, it should prove itself to be of real and tangible assistance in reconstructing agricultural economy and in uplifting the cultivator Rural financing should be helpful in arresting the instability of agricultural prices, the unremunerative conditions of land-tenure and the exorbitant rates of interest, which are the prevailing evils of our agricultural economy The credit agency should prove a useful and attractive alternative to the money-lender. Unless the agricultural financial system is organised along these lines, it may not be expected that adequate credit facilities will be provided for the cultivator. Given this, it will be possible to meet his normal credit needs Such an improved agricultural financial system should be linked with the organised money market of the country. The lines along which this link can be set up will be discussed in the following chapters.

CHAPTER VII

BANK OF ISSUE AND RURAL CREDIT

Central banks or banks of issue play an important part in providing, controlling and organising rural credit facilities. The supply of credit for agriculture should be elastic. Demands for agricultural credit and the period over which these demands are made vary from vocation to vocation and from industry to industry. These variations offset each other to some extent; but the seasonal nature of agricultural industry must be recognised. Seasonal and market conditions vary considerably from year to year. At times, great strain is placed on the sources of rural credit by the increased demands caused by adverse conditions. As pointed out by the Royal Reconstruction Commission of of Australia in its Fifth Report, "These extra demands for rural credit can be met only by a strong policy of control by the Central Bank over the creation and distribution of money credit backed by sufficient confidence to create additional credit of this nature to balance an increased flow of goods coming on the market."[1] Without such a policy, agricultural operations in respect of production and marketing are likely to suffer considerably with grave effect on the producers. Hence central banking operations in respect of discounts and advances are of special importance in relation to their responsibility as controllers of credit. It is by these activities that the supply of available credit is ordinarily regulated. The orthodox view is that a central bank should not provide day-to-day normal

1 See page 15 of the Report.

finance for agriculture or industry but central banks are rendering a great financial help to agriculture in various countries In countries like Australia Argentina and Brazil special departments of the central bank have been set up to provide agricultural credit while in the case of other central banks special facilities are granted for financing agriculture by giving special terms regarding interest and period of time in rediscounting agricultural paper The fact that the Financial Committee of the League of Nations devoted its attention to an elaboration of principles subject to which central banks should extend help in providing agricultural finance indicates the important part which such banks should play in providing agricultural finance In September 1937, the Assembly of the League of Nations asked the Economic and Financial Organisation to arrange for the study of systems of agricultural credit and insurance with a view to the elaboration of principles calculated to strengthen internal and external credit and suitable for adoption by countries contemplating a modification of their legislation on this subject Thereafter M Louis Tardy conducted an inquiry into the subject. One of his recommendations was to the effect that banks of issue should also in each country pay heed to the agricultural situation and grant whenever possible,..... special terms as to interest and duration in connection with the rediscounting of paper submitted by agricultural credit institutions [1] Attention was also devoted to the subject in another publication of the League of Nations entitled *Agricultural Credit Mediate Term Credit to Industry* in which emphasis was laid on the necessity of developing a proper relationship between the central bank and the organisation of agricultural credit The General Assembly of the International Commission of Agriculture in

[1] See page 46 of the Report

July 1936, stressed the importance of defining the form of agricultural credit best suited to modern agricultural requirements and emphasized the need of securing the assistance of banks of issue in respect of agricultural credit. It undertook to present a report on the question at the Hague Conference in June 1937 at which a comprehensive resolution was passed, part (2) of which is given here for ready reference. It is : "That in each country, the Bank of Issue should take into account the conditions of agricultural production and that it should grant special rates of interest and of periods, and allow for the discount of the funds subscribed by the farmers."

M. Tardy's report further mentions on page 16 that the rate of interest on loans must be adapted to the particular conditions of agricultural production with due reference to the nature of the operations which the loan is designed to facilitate. This rate varies with the fluctuations in the price of money on the money market which is itself influenced by the discount rate of the Bank. Hence there should be as close a connection as possible between the agricultural credit organisation and the bank of issue. M. Tardy further pointed out that the Board of Directors of the Bank of Issue should include representatives of the Central Agricultural Credit Establishment, as in France and Czechoslovakia.

Central banks are of comparatively recent origin and there is no universally recognised technique of central banking. The first central bank was the Bank of England, which developed powers and practices suitable to the peculiarities of the monetary and banking system within which it has to work. In regulating credit the Bank of England made use of the bank rate and of purchases or sales of securities in the open market. The working of

these powers required the existence of a specialised short-term money market. It also required that the banks and the money market should respond to the action taken by the central bank. As central banks developed elsewhere, they began to employ different methods to regulate the volume of credit. They also began to render financial help to agriculture which was suitable for their particular conditions For a country like India the methods and practices of central banks of agricultural countries should be more commendable than those of the Bank of England It cannot be expected that the regulation of the volume of credit in India could be achieved by a central bank which merely copied the methods appropriate to a different and much more highly specialised monetary and banking system. The Reserve Bank of India should, therefore, devise powers which may enable it to exercise control over the volume of credit in our country irrespective of whether that power has been used by any other central bank, or is appropriate to any other central banking system India is a country where an overwhelming majority of the people obtain their livelihood from agriculture The policy of the Reserve Bank of India should, therefore, be so directed as to promote the best interests of agriculture

Concession in Rediscounting :

In order to judge what the Reserve Bank of India has done or ought to do in respect of provision of agricultural credit facilities a study of the methods and practices followed by central banks in other countries, particularly agricultural countries, is indispensable In most countries, the bank of issue gives a concession in discounting agricultural bills. This is so in case of Chile, Columbia, Czechoslovakia Greece and many other countries. In Chile, the rate of interest for operations with the Institute of Agricultural

Economy is 3 per cent per annum but in other cases it is 4½ per cent per annum. In Columbia the prevailing rate of the central bank in the pre-war period was 4 per cent for ordinary loans and discounts but it was 3 per cent for agricultural loans and discounts.[1]

Longer Period of Time :

In many countries rediscounting facilities for agricultural bills are provided for a longer period of time than is the case for commercial bills. For instance in the United States of America the period for agricultural bills is 9 months whereas it is 90 days for other bills; in Ireland it is 12 months for agricultural bills but 6 months for others, in Canada the period of time for agricultural bills is 180 days whereas in other cases it is 90 days. In Chile, the provision is the same as in Canada. A maximum limit in many cases is provided for the holding of agricultural bills. In Columbia this limit is one-half of the Bank's capital and surplus; in Estonia, it is 40 per cent of the paid up capital while in Rumania it is 40 per cent of the total bills. In Chile, the total amount lent by the Bank against the documents of a usance more than 90 days must not exceed one half of its paid up capital and reserves. The Canadian Bank Act provides that the Bank may by regulation limit to a percentage of its total assets the amount of such paper having a maturity in excess of 90 days excluding days of grace but not exceeding 180 days excluding days of grace from the date of acquisition by the Bank.

Direct Facilities :

Thirdly there are central banks which grant direct credit facilities to agriculturists. The Bank of

1 See the Annual Report of the Bank of the Republic of Columbia for 1936-37.

Latvia grants direct loans to agriculturists of approved credit and standing entered on its list, and agriculturists can also obtain funds directly, within limits, from the Reichsbank. According to its regulations, the Swiss National Bank is allowed, among other transactions to discount bills and cheques issued to "order" arising out of agricultural dealings, on condition that they are based on commercial transactions, the due date does not exceed three months, and they bear at least two signatures of persons or firms known to be solvent and independent of each other. Thus it indicates that persons or firms known to be solvent can get direct rediscounting facilities from the Swiss National Bank. Here it may be pointed out that these bills constituted in the past only a comparatively small amount of the total of the National Bank's holdings, Only exceptionally did these bills originate from individual farmers Usually they were issued by agricultural co-operative societies in order to cover certain export transactions The Norges Bank also appears to be making direct advances Section 15 of the Bank Act provides that the Bank can make advances against security for not more than 6 months, the shares of the Bank may not be accepted as security It can also make advances on current accounts for periods not exceeding 12 months on security received or on mortgage of immovable property The Bank, of course, specialised in rural credits, but agriculturists can obtain loans on various securities.

Contribution towards Capital Stock:

There are certain central banks which have contributed funds towards the capital of special agricultural banks. The Central Bank of Bolivia contributed 30 million Bolivianos towards the capital of the Bank for Agriculture.[1] The Bank of

1 See page 91 *Money and Banking* 1942 44, League of Nation

England is a shareholder of the Agricultural Mortgage Corporation which was set up in 1929 The *Agricultural Credit Institution* in Chile can, subject to certain conditions, issue bonds for ten years up to 40 million pesos annually. They are guaranteed by the State and mav be taken up by the Central Bank of Chile The Bank of Chile has also lent 300 million pesos to the Agricultural Credit Institution towards the latter s capital. The President of the Republic is authorised to issue Government bonds to the Bank up to 370 million pesos which are used to cancel the obligations of the Agricultural Credit Institution to the Bank of Chile The Bank of Norway is allowed to invest funds in the bonds of the Norwegian State Bank and in those of the Norwegian Mortgage Bank Both these institutions grant long-term loans to agriculturists In the Netherlands, a corporation *called Company for the* Financing of National Reconstruction was founded by virtue of the Royal decree of September 3, 1945 51 per cent of the total capital of this Bank for Reconstruction is in the hands of the State and the rest has been taken over by the commercial banks and the investment companies in the form of preferred shares The Netherlands Bank has participated in the preferred capital of the new institution for ·3 million

State Funds :

There are central banks with whom State places special funds to be granted by way of loans in conformity with special regulations The Sveriges Riksbank or the Bank of Sweden is allowed to do so under Article 18 of the Bank Act. There is one such fund whose purpose is to support the farmers by advancing on cereals but This form of credit is at present of practically no importance [1]

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1 See Appendix A reply of the Bank dated 6th May 1947 to my *questionnaire*

The National Bank of Denmark also grants loans against State guarantee to Marl Associations, i.e., co-operative associations of the ground owners for carrying out local work These loans are charged the lowest rate of interest of the National Bank of 4 per cent per annum, and have a term of 12 to 15 years. The National Bank may, however call these loans from the State with a notice of 3 months The total amount of such loans came to 1,197 608 Kr. in 1945 while the corresponding amount for 1946 was about one-half millions Kr [1]

Encouraging Agricultural Production:

There are certain banks which have encouraged agricultural production in a special manner For example, during the Second World War the Swiss National Bank facilitated the financing of agricultural production which had been considerably intensified by way of rediscounting the so-called "melioration' bills These bills can be drawn by Agricultural Corporations, Rural or Municipal Communities, and the Sovereign States within the Swiss Confederation for financing the melioration of land, specially the clearance of woodland for cultivation, the draining of marsh land etc In every case in which the National Bank placed their credit at the disposal of agriculture, it was to provide working capital for agricultural development, but mortgages cannot be authorised owing to the special constitution of the Bank The Central Bank of Chile tried to encourage agricultural production by extending financial help to the Agricultural Credit Institution, to the Institute of Agricultural Economy and to the Agricultural Colonisation Institution The respective loans to these institutions rose from 50 million pesos in

1 See Appendix A reply of the National Bank of Denmark of June 13 47 1947 to my *questionnaire* and the *Memorandum sent* by the Bank with it *Also* see page 70 of the Annual Report of the Bank for 1945 English Translation

1937 to 546.2 million pesos in 1945 As a result agricultural production rose by 6.4 per cent in 1944; although during the War years it had a falling tendency[1]

Japanese Practice :

The Bank of Japan does not legally provide any particular privilege or convenience in respect of agricultural bills In fact, the discount market has not yet been fully developed there. Actually almost no agricultural bills are in circulation. None the less the Bank of Japan has done much towards smooth operation of agricultural finance by discounting food certificates issued by the Government Many food commodities like rice and wheat are purchased by Government to ration food among general consumers. They constitute 40 per cent of the total value of agricultural products The Government deliver the food certificates to the Japan Agricultural Association, which is the purchasing agent of the Government. These certificates bear interest of Sen 1.1 per diem with a period of around one month. These certificates are known as the "delivery food certificates." If farmers want cash, the Agricultural Association discounts these food certificates with the Bank of Japan Actual transactions were made between the Central Co-operative Bank and the Bank of Japan, because the former was acting as the agent of the Japan Agricultural Association as to acceptance and discount of food bonds.

On and after February 1, 1947, the Government began to make cash payments. Hence it will hereafter issue bills redeemable within one year or borrow funds at the expense of the "food control special account." The Bank of Japan will either underwrite the bills or make advances to the special

1 Vide the reply of the Central Bank of Chile to my *questionnaire*

account In this way the Bank of Japan will provide financial accommodation to the Government for purchasing agricultural products The value of *food certificates purchaseed by the Bank* between September 1946 and March 1947 came to 15 710 million yen The Bank makes loans to other institutions also The following table gives details about such loans outstanding on May 31 1947 —

Loaned to	Loan Balance (in 1 000 yen)	Purpose	Mortgages	Rate
Hypothec Bank of Japan	68 200	Funds for deposit payments	Government bonds	Sen 1.11
Central Co operative Bank of Agriculture & Forestry	7 6[illegible]1 154	Funds for deposits payments & loans to affiliated organs		Sen 1.1
Prefectural Agricultural associations	10 000	Funds for deposits & payment		Sen 1.1

Thus the Bank of Japan extends credits to tillers or their associations through local financial institutions. It assists the institutions mentioned in the above table by providing temporarily needed funds In fact the Central Co operative Bank of Agriculture and Forestry is the nucleus of finance business of various agricultural co operative unions In rendering assistance to banking organs in farm villages the Bank of Japan does not make current overdrafts without interest or with preferential rate of interest but the supply of funds by discounting Government issued food certificates may be taken as financial accommodation on preferential rate of interest in view of the low rate of discounting of sen 0 65 in the case of conversion food certificates and sen 1.1 in the case of delivery food certificates

New Zealand Practice :

The Reserve Bank of New Zealand is authorised to discount, rediscount, buy or sell bills of exchange *arising out of agricultural transaction in* New Zealand. A recent amendment to the Act empowers the Bank to grant accommodation by way of overdrafts ' to any Board or other authority having statutory powers in relation to the marketing of New Zealand produce, for the purpose of financing the purcha-e and marketing of any such produce."

The following table gives the amount of advances made by the Reserve Bank of New Zealand to the Government for its guaranteed prices scheme for dairy produce and for its wartime bulk purchase agreements for exporting farm produce[1] :

Year	Name of the Undertaking	Amount £	sh	d
1938	Primary Products Marketing Department	5 200 848	17	5
1939	Do	7 235 461	15	2
1940	Marketing Department	3,526 640	4	8*
1941	Do	2 926 463	0	6
1942	Do	7 720 632	11	9†
1943	Do	4,219,613	3	2
1944	Do	1 643,272	16	1
1945	Do	1 216 076	7	11
1946	*Marketing Organisations*	*1 578 919*	*10*	4

1 *This table has been compiled with the help of the Annual Reports of* the Bank for the years ended 31st March 1938 to 31st March 1946

* *The transactions from this year began to* embrace a wider range of commodities than was the case prior to the War This development was a consequence of the new basis on which the Dominion's export of dairy *produce* meat and wool *were purchased by* the United Kingdom Government. Before the War dairy produce was the only export commodity financed by advances from the Reserve Bank The new arrangements provided for dealing with wider range of exports See Annual Report ended 31st March, 1940 pages 8 to 11

† *The rate for accommodation to the Government* were reduced from 26th July 1911 to 1 per cent per annum on the first £ 5 000 000 and thereafter 1½ per cent per annum

Thus the Bank of New Zealand grants overdraft accommodation to Government departments. A perusal of the annual reports of the Bank indicates that it is allowing the Marketing Department to operate four accounts, viz, the Dairy Industry Account the Meat Industry Account, the Wool Industry Account and the Sundry Products Account Each of the four accounts could, according to circumstances, be given credit or overdraft The actual amount of the overdraft has varied from time to time, and it went up to about £ 7,720,000 in 1942. The Bank of France and Hungary also grant overdraft accommodation to Government or Government departments. For instance, the Bank of France in 1944 is reported to have placed at the disposal of the Government a sum of 40 million francs free of interest for subsidising the rural credit banks

Open Market Operations and Discount Policies :

Certain central banks have so conducted their open market operations and discount policy as to have lowered the rate of interest in the country and helped agriculture. In this connection the cases of the Bank of Canada and the Bank of Denmark may be mentioned on the point. The Bank of Canada has conducted its open market operations and easy money policy in such a manner that it has led to an appreciable decline in the level of interest rates In the early Nineteen Thirties, the yield on long-term Government bonds was about 5 per cent, but it fell to about 3 per cent by 1936 and at present (1946) it stands at about 2.6 per cent. Other interest rates have tended to decline roughly by the same amount as in the case of Government bonds The typical rate of interest of the commercial banks on agricultural mortgages and farm loans is at present about 5 per cent; but in the early Nineteen Thirties, the comparable rate

was about 7 per cent. The Bank of Denmark has, through its discount policy and open market operations caused a lowering of the level of interest ; and it has supported agriculture and other trades through this channel. For agriculture this decrease of interest has entailed a conversion of a part of its dear 4½ per cent and 5 per cent mortgage loans to 4 per cent. This conversion involved an amount of Kr. 500 million or one-third of the total mortgage debt of agriculture carrying high rates of interest. Further, owing to the monetary expansion between 1940 and 1945 there was marked decrease in the level of interest in that country, so that farmers could obtain long-term mortgage credits from the private credit associations at an actual rate of interest of about 6.3 per cent.

Australian Practice :

The case of the Commonwealth Bank of Australia may be mentioned to illustrate as to how the volume of credit is regulated and directed into proper channels on appropriate rates of interest. It has been the policy of the Central Bank of Australia that credit should be available to persons engaged in agricultural operations at reasonable rates of interest. The Commonwealth Bank lends on overdraft terms direct to individuals engaged in primary production, to pastoral finance companies and to other bodies which, in turn, lend to primary producers. This is done by the General Banking Division of the Bank. Such advances are made at a rate of 4½ per cent per annum or lower. This rate was brought to this level in November 1934. Certain pastoral companies were customers of the Bank. When a pastoral company makes loan to a customer, it is attracted by the commission and other business, besides interest, which the loan brings. It may lend its funds at cost or with a very small margin. When the Commonwealth

Bank lent money to its customer companies at 4½ per cent and this money was re lent at approximately the same rate it tended to bring down the rate at which money was lent by other pastoral companies While this continues the Bank influences the rates of interest on seasonal loans in the pastoral industry Where the trading banks make this type of seasonal advances pastoral companies compete with them in that particular field of their operations The action of the Commonwealth Bank influences their rates Thus the loan operation of the General Banking Division of the Commonwealth Bank has tended to lower the rate of interest for agricultural credit[1] It may be said that the rates of interest charged by the State Rural and Agricultural Banks and corresponding institutions vary between 3¼ per cent and 4½ per cent per annum The Commonwealth Bank fixes the maximum rates of interest to be charged by pastoral finance companies and the present rate of interest fixed is 5 per cent per annum. Maximum rates have been fixed in respect of loans made by co-operative societies generally. In its capacity as the central bank the Commonwealth Bank since March 1942 has fixed progressively lower rates of interest as being the rates at which other institutions may lend money Before maximum rates were fixed by the Commonwealth Bank, it had been the practice of banks to lend at 6 to 7 per cent or more, but the Commonwealth Bank has now fixed 4½ per cent per annum as the maximum rate at which banks may now make advances the rate for pastoral companies being fixed at 5 per cent In this way, agriculture has benefited financially.

The General Banking Division lends to primary producers on overdraft terms, and the advances are theoretically payable on demand , but in the majority

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1 See Report of the Royal Commission on Monetary and Banking Systems in Australia 1937 page 217

of cases they are granted with the knowledge that they will not be repaid for a number of years[1] The period of repayment is, of course, determined when the advance is approved and it varies according to the circumstances, such as the purposes for which the money is required and in the case of primary producers the kind of production in which the borrower is engaged No maximum limit is fixed for individual advances made by the General Banking Division to primary producers. These facilities provided by the Commonwealth Bank are in addition to those provided by the Rural Credit Department and the Mortgage Banking Department, an account of which is given in the following chapter

Certain central banks also encourage or discourage the import or export of agricultural produce. Near about 1916, the Bank of Japan requested the Cotton spinners and raw-cotton importers to minimise the import of Indian raw cotton and import from America instead It was because sufficient funds were not available in India to settle the accounts[2]

Allocation of Profits :

Certain central banks allocate a portion of their profits for agricultural finance. This is done in the case of the Commonwealth Bank of Australia, which earmarks 50 per cent of the net profits of its Rural Credits Department for the credit of a Rural Credits Department Fund, the monies in that Fund being used for the promotion of primary production Disbursements from this Fund have been made for purposes such as agricultural farming and pastoral improvement experiments, cattle research, importation of pedigree stocks, fodder conservation, etc The total amount disbursed in this manner is £430,000. It appears the Central

1 *Vide* letter of the Commonwealth Bank dated 5th June 1947 in reply to my *Questionnaire*

2 See Appendix A reply of the Bank of Japan to my *Questionnaire*

Bank of Chile also earmarks a portion of its annual net profits for this purpose The Central Bank of Chile earmarked profits for agricultural finance as below :—

First half of 1946	...	$ 8,138,947,40
Second half of 1946	...	$ 12,485,815,92
First half of 1947		$ 16,267,361,85

In the case of certain foreign central banks, viz., the Bank of Argentina the Bank of Brazil and the Commonwealth Bank of Australia, special departments have been organised to provide credit facilities for agriculturists A brief account of them is given in the following chapter.

Conclusion :

Foreign central banks are providing facilities for agricultural finance in a number of ways. Some of them allocate a portion of their profits for agricultural finance, while others have organised special departments to provide agricultural credit facilities The provision of rediscounting facilities is a common feature of a number of central banks, Empire and foreign. Many Empire banks—the Bank of Canada, the Reserve Bank of New Zealand and the South African Reserve Bank—offer such facilities in respect of *bonafide* transaction covering the production and marketing of primary products. Among foreign central banks, the Swiss National Bank the Svergis Riksbank (Sweden), the Bank of Greece the Bank of France, etc., provide special rediscounting facilities in respect of agricultural paper Many of the Banks offer concession in rediscounting agricultural paper both with regard to rate of interest and period of time The grant of overdraft accommodation to Government or Government Departments is another way in which agriculture is financed by foreign central banks The cases of the Bank of France and the Bank of New

Zealand have already been mentioned. Some of the central banks, viz, those of Sweden, Switzerland, Norway, Greece, Australia, etc, are reported to be offering direct credit facilities for agriculture. Certain Banks have also contributed funds towards the capital of Central Agricultural Banks, viz, the Central Bank of Bolivia The Bank of Canada and Demark have lowered the rate of interest in their respective countries through their discount policy and open market operations and these have helped agriculture. Certain other central banks regulated the maximum rate of interest at which credit is to be allowed to the primary producers by credit agencies as is done by the Commonwealth Bank of Australia Many of the foreign central banks also provide special facilities for co-operative institutions. The Bank of Latvia discounts 6 to 9 months bills of Land Credit Societies at 4 per cent per annum. The Swiss National Bank discounts the paper of co-operative societies for various purposes The Bank of France and Netherlands also grant credits to Co operative Central Banks The Bank of France has advanced to the Government a sum of $ 8 000 000 free of interest for subsidizing the co-operative bank, the subsidy being a loan It has also to pay a sum equal to ⅛ per cent of its yearly note circulation to the Government for the same purposes, subject to a minimum of $ 4 000 000. Some banks, *eg*, the Central Bank of Turkey, are authorised to secure under State guarantee the necessary funds for making medium and long term loans to agricultural financial institutions Many banks have placed funds at the disposal of the Government for settling farmers' debts The National Bank of Hungary placed at the disposal of the Government about 75 million pengos to enable it to finance the Debt Settlement Scheme of the insolvent farmers as a relief measure Some central banks discourage the imports of agricultural products

by refusing import credits. This was done by the Bank of Latvia in 1926 when agriculture was threatened by influx of foreign grain The Bank of Japan owing to paucity of funds, discouraged the imports of cotton from India in 1916 This account will be helpful to appraise the part played by the Reserve Bank of India in organising agricultural credit facilities in our country

CHAPTER VIII

FOREIGN CENTRAL BANKS AND MEDIUM-TERM AND LONG TERM AGRICULTURAL FINANCE

A perusal of the available literature indicates that central banks of several foreign countries have organised special departments to provide medium-term and long-term financial facilities for agriculture and small industries connected, *inter alia* with agriculture A brief review of the functions and working of such departments of foreign central banks is made in this chapter in order to see how far the organisation of similar departments by the Reserve Bank of India will be possible in our country The Bank of Argentina, the Bank of Brazil, the National Bank of Costa Rica, the Commonwealth Bank of Australia and the Bank of Iceland are reported to have organised such departments; but unfortunately adequate information about their constitution, functions and working, leaving out the case of the Commonwealth Bank, is not available

The Argentine National Bank

The Agricultural Credit Department of the Argentine National Bank was established in 1933 to grant loans to agriculturists and agricultrural co-operatives It could grant loans as below ·[1]

(1) Loans for a period not exceeding 8 months with or without security *in rem* to cover costs of harvesting up to a maximum of 10,000 pesos.

1 See Tardy's Report pages 63 and 64

(2) Loans for a period not exceeding 1 year, with or without security *in rem* for working capital up to a maximum amount of 10 000 pesos

(3) Loans for periods of less than 6 months with security *in rem* 'warrants', to facilitate the marketing of produce

(4) Loans for a period not exceeding 2 years with security *in rem* for purchasing livestock and equipment to a maximum of 10,000 pesos.

(5) Loans for a period not exceeding 2 years, with or without security *in rem*, for the creation of plantations, under the provisions of the Ministry of Agriculture, to a maximum of 20 000 pesos

(6) Loans on mortgage or pledge for a period not exceeding 5 years, for purchasing farms, for making improvements in land, for erecting buildings etc to a maximum of 30,000 pesos

The rate of interest was not to exceed 6 per cent. The Department may make loans to credit co operatives up to the extent of the paid-up capital of co-operative societies The funds of the Department are made available by the Argentine National Bank from its registered capital and reserves, from deposits and from the general resources of the Bank The Bank assists the National Mortgage Bank in respect of mortgage loans made to agriculturists by making enquiries into applications for loans in places where the National Mortgage Bank has no branches. It facilitated the purchase of land for cultivators, and by December 31, 1936, it advanced loans to agriculturists up to about 107 million pesos The Department is reported to have organised Mutual Agricultural Insurance against hail, frost and

other risks. According to the information supplied by the Agricultural Credit Department of the Reserve Bank of India to me, the Agricultural Credit Department of the Bank of Argentina was organised in 1940 as a sort of information service regarding debtors and the necessity of periodical review of balance sheets and financial statements of other institutions It extended credit facilities to the agriculturists and agricultural co operatives, pending the creation of the National Agricultural Credit Bank

Brazil:

The Bank of Brazil[1] has also organised the Credit Department for agriculture and industry.[2] The funds of the Department are, *inter alia*, obtained from the sale proceeds of the bonds. Mortgage bonds issued under the Law of 1938 to pay off the debts contracted by agriculturists reached a level of 5 million cruzeiros It is giving adequate financial help to the small producer The loans made by it for a number of years are given below.[3]

	End-of month balances. (1,000 000 cruzeiros)		
Year	*Rural*	*Industrial*	*Total*
1938 December	41	5	46
1939 „	133	65	198
1940 „	341	94	435
1941 „	587	230	817
1942 „	1,109	219	1328
1943 „	1,312	369	1681

1 The Bank of Brazil is not a Central or Reserve Bank It is a Joint Stock Company of which the Federal Government is the largest share holder with about 55 73 per cent of the stock As yet there is no Central Bank in Brazil

2 See the Annual Report of the Central Bank of Brazil for 1943

3 Ibid page 26

The above table shows that the rural loans made by the Bank at the end of December amounted to 1 312 million cruzeiros

Costa Rica and Iceland :

The National Bank of Costa Rica has a Mortgage Department and also an Agricultural and Industrial Credit Department The Banking Department made loans amounting to 4 3 million colones to the Mortgage Department and loans amounting to 9 1 million colones to the Agricultural and Industrial Credit Department in 1943 the total of all loans made by the Department being 53 5 million colones in the year The National Bank of Iceland also appears to have a Mortgage Department [1]

Australia :

The Commonwealth Bank of Australia has at present three Special Departments a Rural Credits Department a Mortgage Bank Department and the Industrial Finance Department Their organisation functions and working are given below :

(1) The Rural Credits Department This Department was created in 1925 under the Commonwealth Bank Act Part VIII of the Commonwealth Bank Act XIII of 1945 mentions its functions and constitution, from a study of which it will be noted that through this Department the Bank makes advances to co operative associations marketing boards and other bodies for facilitating the marketing of primary produce in an orderly manner Through these bodies producers are supplied with financial assistance pending the sale of their produce In this way the orderly marketing of Australia s primary produce is facilitated

1 See *Money and Banking 1942 44 League of Nations* pages 100

Advances are made on the security of primary produce placed under the legal control of the Bank The security generally takes the form of a floating charge, storage warrants and similar documents of title replaced by shipping documents when the produce is exported As the pool or co-operative society effects sale, the proceeds given to the Bank as holder of documents of title are applied in clearing the advances made to individual producers The period of loans does not exceed one year and the present rate of interest charged for advances on rural credit terms is 3½ per cent per annum or lower Towards the capital of the Department the Commonwealth Bank of Australia allocated 25 per cent of the net annual profits of the Issue Department up to a total of £ 2,000,000 which amount was attained as early as 1932 Temporary finance, as and when necessary, is made available to this Department by the Treasurer of the Commonwealth Bank, and the total of the sums so lent and not repaid shall not exceed £3,000,000 The Bank may also make advances to the Rural Credits Department of such amount and subject to such terms and conditions as the Governor determines

Rural Credits Development Fund :

One-half of the net profit of the Department is placed to the credit of a Rural Credits Development Fund, the monies in that Fund being used for promoting primary production Disbursements from this Fund have been made for purposes such as agricultural farming and pastoral improvement experiments, cattle research, importation of pedigree stock, fodder conservation etc The total amount disbursed in this manner is £430 000 The total advances made to commodity boards whose drawings during the year ended 30th June 1946 amounted in all to over £95 000,000 ; while advances totaling over £26 million were also made available to

finance the export of meat, butter, cheese and dry fruits to the British Ministry of Food[1] Approximately £523 million had been advanced by the Bank on Rural Credits Terms between the commencement of the Department and the 30th June, 1946

In the majority of cases in which advances have been made, the borrowing authority, *viz.*, the associations of growers has practically no assets other than the commodity advanced against In spite of this, the percentage of the advances to the market value of the particular commodity has been materially higher than would be made as a normally banking proposal. This has been of considerable practical importance to growers, many of whom require immediate payment of the greater portion of the proceeds of their produce to meet the expenses of harvesting and the carrying on of agriculture

Co-operation amongt producers of agricultural commodities has been definitely encouraged by the Department inasmuch as its loans are to be made to co-operative societies which are associations of small producers. The Department has made rural credits advances at a rate materially below the overdraft rate which is a recognition of the special assistance in respect of finance which agriculture as a national industry deserves at the hands of the central bank

Reduction in Interest :

The Department has brought about a progressive reduction in the rates of interest on advances made by it In 1936 the rate of interest on advances was 3¾ per cent per annum , but the present rate of interest charged on advances on Rural Credits Terms, as noted above, is 3¼ per cent per annum or lower. In 1925 it was 6¼ per cent. It was reduced

1 See page 11 of the Annual Report and Balance Sheet of the Commonwealth Bank of Australia for 1946

to 6 per cent in 1927, to 5½ per cent in 1929 and 4½ per cent in 1932[1] The Bank has not thought warranted to formally prescribe the maximum rate of interest to apply to loans, if any, made by the particular bodies concerned to primary producers To some extent, such loans are already covered by the maximum rates fixed For instance, maximum rates have been fixed in respect of loans made by co operative societies generally

The Rural Credits Development Fund has been used to make grants to the Council for Scientific and Industrial Research and for other useful purposes connected with the growth of primary produce Up to 1936 grants exceeding £200,000 were made since its inception

Thus the Rural Credits Department of the Commonwealth Bank is directly entrusted with funds It makes loans not directly to individuals but to co-operative associations, banks and other associations on the security of primary produce placed under its legal control. It has definitely encouraged the co-operative movement Funds have also been made available for scientific research It has also brought about a reduction in rates of interest Hence a study of its functions and working is of particular importance from the point of view of our country

Mortgage Bank Department :

This Department was established in 1943 in order to provide finance for persons engaged in farming—agricultural, horticultural, pastoral—or grazing operations or in other forms of primary production acceptable to the Bank The security required is a first mortgage on land used for primary production The period of loans is not less than

1 See Annual Report of the Commonwealth Bank for 1936, page 26

5 years and not more than 41 years. The maximum amount lent is £5,000 or 70 per cent of the valuation of land on which the loan is secured, whichever is less

A mortgage given as security for repaying a loan usually provides for the payment in equal half-yearly instalments of principal and interest. The amount of each instalment shall be a sum equal to 6 months' interest on the original amount of the loan together with an amount not less than ½ per cent of the original amount of the loan

The interest rates are 4 per cent for loans up to 20 years and 4½ per cent per annum for loans for 21 to 41 years The purpose of the loan can either be purchase of land bearing on primary production or discharge of prior debts.

Loans outstanding on 30th June, 1946 stood at £2,463,143[1] Loans made through the Department total £3,600,000 Towards the capital of the Department amounting to £4 million the Act (Sections 15, 47, and 76) provided as follows:

(1) One-fourth of the annual profits of the General Bank Department,

(2) £150,000 a year from the profits of the Note Issue Department, but no payment shall be made in this connection so as to increase the capital of the Mortgage Bank Department to more than £4 million, and

(3) Transfer of £1 million from the special reserve in the Note Issue Department.

The Bank is authorised to make advances to the Department subject to the amount outstanding at any time not exceeding £1 million. The Commonwealth Savings Bank may also make advances to the

1 See page 11 of the Annual report of the Commonwealth Bank of Australia for 1946

Bank for use in the Mortgage Bank Department of such amounts and subject to such terms and conditions as the Governor determines The Commonwealth Treasurer may raise loans for the Department and lend the necessary funds to it, subject to such terms and conditions as are agreed upon between the Treasurer and the Bank.

Rural indebtedness in Australia is something like £400 million without allowing for trading debts for farming implements and supplies generally This Department will enable farmers to obtain long-term loans at reasonable interest rates and give protection to them against pressure for repayment in difficult times In the post war period it will be of great help to reconstruction

The Industrial Finance Department :

It was established on 2nd January, 1946 with an initial capital of £2 million, one-half of which was transferred from the Note Issue Department and one half from other funds of the Bank. The main function of the Department is to finance the development of industry, particularly where small undertakings are concerned for which financial accommodation is not readily available through ordinary banking or other channel Finance is required for production and for distribution and the Department aims, by combination of overdrafts and hire purchase accommodation, to finance in sequence the manufacturer, the distributor, the retailer and the individual purchaser At the end of the year 1946 outstanding loans were £834,469

CHAPTER IX

THE AGRICULTURAL CREDIT DEPARTMENT OF THE RESERVE BANK OF INDIA

The Agricultural Credit Department of the Reserve Bank of India was established in April 1935 under the provisions of Section 54 of the Reserve Bank of India Act Before the creation of the Bank Sir Malcolm Darling was asked by the Central Government to express his views on the constitution of the Agricultural Credit Department His report on the co op rative movement and a note containing proposals regarding the constitution of this Department were received by the Bank near about the end of June 1935 Sir M L Darling in the above mentioned note summed up the duties of the Department as below —

Firstly it must be in a position to advise the Bank in regard to its financing of the co-operative movement especially in the field of land mortgage banking, and for this purpose it must be expert in co operative finance and familiar with the working of the movement throughout India And since co operation is a world movement it will be well advised to gain some knowledge of the movement in countries whose conditions at all resemble those in India

Secondly it must get into touch with all commercial banks in any way financing agriculture and examine whether their operations can be co ordinated to the advantage of the agriculturists

Thirdly it must explore the whole field of

indigenous banking and obtain the information that the Bank will require for its report under Section 55 (1) (a)

Finally it must make a systematic study of the whole field of agricultural credit in India in order to be able to advise the Bank as to what action it should take in regard to Section 55 (1) (b)

Functions ·

The Bank then asked the provincial governments for detailed information regarding agricultural credit agencies in India and its preliminary report was submitted to the Government of India under Section 55 (1) of the Reserve Bank of India Act after considering these replies As mentioned in Section 54 of the Reserve Bank Act the functions of this Department are (1) to maintain an expert staff to study questions of agricultural credit and be available for consultation by the Government Provincial Co operative Banks including Burma Co operative Bank and other banking organisations and (2) to co ordinate the operations of the Bank in connection with agricultural credit and its relations with Provincial Co-operative Banks and any other banks or organisations engaged in agricultural credit The Department is under the charge of an officer who is assisted by the Director of Research In internal administration there are three sections of the Department viz the Agricultural Credit the Banking and the Statistical and Research Sections A Research Division was recently added The Agricultural Credit Section studies problems relating to rural finance and keeps itself in touch with the co operative movement The results of its studies are published in the form of bulletins It also places its services at the disposal of the Government and banking organizations which may like to consult it in connection with agri

cultural credit. The Banking Section deals with problems relating to the scheduled and the non-scheduled banks and the Research Section studies statistics relating to the economic development of the country with reference to production, trade, prices and currency This section is entrusted only with work of statistical and research type and compiles the annual report on currency and finance in co-operation with other sections of the Department It also undertakes research work from time to time on subjects in which the Bank as the central monetary authority of the country is interested

It will thus be seen that the functions of this Department are to maintain an expert staff to study questions on agricultural credit and to give advice to banks and Governments and to co-ordinate the operations of the Bank regarding agricultural credit with other banking institutions of the country. It is not directly entrusted with funds as are the Agricultural Departments of some foreign central banks whose operations are discussed above. Such loans are made by the Banking Department of the Reserve Bank of India under the provisions of Section 17, The Reserve Bank of India has, from time to time, made suggestions through this Department for reforming the agricultural credit system of the country by utilising the various agencies engaged in providing agricultural credit in an effective manner It has prepared schemes to link the indigenous banker with the Reserve Bank of India It has also made proposals for utilising the agency of the money-lender and the co-operative movement to improve agricultural credit It has also made suggestions as to the way in which land mortgage banks can get finance from the Bank to help the agriculturists

Efforts to link the Indigenous Banks :

At the outset we may refer to the efforts made by the Reserve Bank of India to bring the indigenous banker within its direct ambit The importance of the indigenous banks in the agricultural financial system of the country has already been described These bankers particularly those of standing have no difficulty in obtaining credit from joint stock banks In respect of the promissory notes and bills of exchange of approved parties purchased or discounted by banks the Reserve Bank Act makes provisions subject to which such banks can obtain advances from or rediscount such paper with the Reserve Bank of India There is however, the question of granting further facilities to the indigenous bankers by the Reserve Bank of India In its preliminary report, the Bank proposed to examine this matter in the light of further information and to communicate its views on the point to the Government of India [1] Here it may be pointed out that Section 55 (1) of the Reserve Bank of India Act required the Bank to make a report to the Central Government before the 31st December, 1937, with proposals, if necessary, for legislation on (*a*) the extension of the provisions of the Act relating to scheduled banks to persons and firms not being scheduled banks, engaged in British India in the business of banking, and (*b*) the improvement of the machinery for dealing with agricultural finance and methods for effecting a closer co operation between agricultural enterprise and the operations of the Bank. This report was published in 1937 in which the part played by the indigenous banker in agricultural finance was appraised It pointed out therein that the indigenous banker depended upon his resources supplemented by those borrowed

1 See pages 26 and 27 of the Preliminary Report of the Reserve Bank of India.

from his relations and also on the credit which he could obtain from the joint stock banks without submitting to any formal restrictions. In these circumstances, there is little inducement for the indigenous banker to submit to restrictions without a clear indication of corresponding advantages

Reserve Bank's Circular of May, 1937 :

In its Circular Ref. No C Cr 427/30-G (10) 37, of 6th May, 1937, addressed to all scheduled banks and the Shroffs' Association, the Reserve Bank of India forwarded certain suggestions for their consideration and undertook to give its careful consideration to any other constructive suggestions that it might receive from them Therein the Bank referred to two obvious facts Firstly, even with the development of branch banking it would not be possible for the scheduled banks for a considerable time to handle the whole of Indian agricultural finance directly, and the indigenous bankers must continue to be an essential part of the Indian banking structure and must be brought within the ambit of the Bank. Secondly, it would not be possible for the Reserve Bank, under the existing conditions, to deal with the indigenous private banks direct in view of their number and of the character of their business. The Banks could deal with them through some intermediate agency which will share the financial responsibility and will undertake the necessary detailed examination and control

It was suggested that for direct dealings the essential conditions were that these organisations should be self-contained legal entities with reasonable resources of their own. They should maintain properly audited accounts and should confine their other business to trading proper and give up speculation They should have a certain amount of publicity and maintain the same deposits with the Reserve Bank as were maintained by the scheduled banks.

Pending direct linking on the above conditions, the Bank suggested that business under sub-section 2 (*a*), (*b*) and (*c*) and 4 (*c*) and (*d*) of Section 17 might be transacted by the Reserve Bank with the indigenous banker through scheduled banks. *Bonafide* trade or agricultural bills originating with merchants or agriculturists and endorsed by the indigenous banker and rediscounted with a scheduled bank or promissory notes drawn by the indigenous banker and discounted by a scheduled bank might be presented for rediscounting to the Reserve Bank. Scheduled banks would have to maintain approved lists of Shroffs with whom they would be prepared to do business showing the amounts of credit which they would have safely accorded and the type of business which the indigenous bankers would do.

The Reserve Bank of India would then make advances against such bills or promissory notes on the following basis :—

(1) It would make demand advances to the scheduled banks against their security under Section 17 (4) (*c*) of the Act. The scheduled banks would be responsible for collecting the bills on maturity

(2) Scheduled banks would classify the bills presented for discount under such heads as might be prescribed by the Reserve Bank and they would keep the Reserve Bank informed of their total advances under such heads to enable the Reserve Bank to see that no scheduled bank was over-trading and that no particular commodity was over-financed.

(3) Such advances would be seasonal to be cleared at the end of the normal season of the commodity in respect of which they had been made.

The Reserve Bank would not attempt to dictate the rates at which scheduled banks woald do business; but it made it clear that it would not like them to charge excessive rates from approved Shroffs

and invited suggestions to prevent same The main object of the scheme was that the scheduled banks, which benefited by it in the first instance, should pass on these benefits in a tangible manner to the indigenous bankers for whose benefit the scheme was primarily devised The Reserve Bank might refuse to accept paper for rediscount if the scheduled banks themselves had discounted such paper at more than a reasonable margin above Bank Rate, say 2 or 2½ per cent. If a scheduled bank charged more than this, it could be easily inferred that the indigenous banker financed by it was not above suspicion In either case the Reserve Bank would be justified in refusing to rediscount such paper.

It is thus clear that the above scheme suggested the linking of the indigenous banker only indirectly to the Reserve Bank of India, i e, through scheduled banks Some of the conditions mentioned in paragraph 4 of the Circular under reference, namely, those relating to the resources and deposits which indigenous bankers seeking direct linking were expected to observe were inconsistent with the recommendations of the Indian Central Banking Enquiry Committee.

Reserve Bank's Scheme of August, 1937 :

The Reserve Bank prepared a scheme in August, 1937 in which concrete proposals were made with reference to the indigenous bankers and others which were based on the report of the Indian Central Banking Enquiry Committee Very briefly it was suggested that if the indigenous bankers were to come into practical relationship with the Reserve Bank, they would have to formalise their methods of business on lines appoximating to joint stock banks, and in particular develop *the deposit side* of their banking activities The indigenous bankers

who wished to be linked directly to the Reserve Bank were to satisfy the following conditions:—

(1) They were to confine their business to banking proper as defined by the Indian Companies Act and they were to wind up their other business within a reasonable time

(2) They were to maintain proper books of account and get them audited by registered accountants The Reserve Bank was to have the right to inspect their accounts and call for any other necessary information in that connection

(3) They were to file periodical statements prescribed for scheduled banks with the Reserve Bank and they were to publish the returns prescribed for banking companies by the Companies' Act

(4) The Reserve Bank was to have the right to regulate their business on banking lines when necessary

(5) During a period of five years from the date of their registration as private bankers in the Reserve Bank's books they were entitled to open an account with the Reserve Bank During this period they were not to furnish the compulsory deposits with the Reserve Bank unless any of their weekly statements disclosed that their time and demand liabilities were five times or more in excess of their capital in the business

(6) Indigenous bankers who did not incorporate themselves under the Companies' Act were to state the amount of capital available for banking business, and bankers with a capital of less than Rs 2 lakhs could not be placed on the approved list of the Reserve Bank

(7) They were to give the names and interests of their partners and the names and interests of co-sharers, if any, if the bankers were members of a Hindu Joint Family

Indigenous Bankers' Views on the Scheme :

In the first instance the scheme was tentative for five years. The Reserve Bank was to make proposals for legislation further to co ordinate or regulate the position of the indigenous bankers if it thought necessary This might be done by a separate Act on the lines of the suggestions of the Indian Central Banking Enquiry Committee. Indigenous bankers satisfying these conditions were to have the privilege of rediscounting with the Reserve Bank against eligible paper and they were to be entitled to get advances against Government paper They were also to have remittance facilities similar to those allowed for the scheduled banks The replies received by the Reserve Bank were not agreeable to the suggestion regarding the taking of deposits and giving due publicity to accounts. Only some of the indigenous bankers were agreeable to the conditions of the Reserve Bank regarding maintenance of accounts in approved form. They were in favour of ruling out speculative business, but they were not prepared to confine themselves to banking business only

In regard to the segregation of banking from non-banking business the indigenous bankers were not agreeable that the provisions of Section 277 (*f*) and 277 (*g*) of the Indian Companies Act be applied to indigenous bankers, but they would not agree to the emphasis put by the Reserve Bank on the acceptance of deposits. It was contended that these sections merely described the business of joint stock banks The indigenous bankers were not prepared to conform to such a description in all its respects. They wanted a precise statement of facilities which should be granted to them It was suggested that banking business as defined in these sections would cover their activities as commission agents, namely, those relating to the purchase of goods in the central markets or at the ports, those

regarding loans advanced for seeds and other agricultural expenses and those relating to selling produce in the central market and crediting the amount realised to the account of the debtor. All these transactions were done for and on behalf of the indigenous banker for which a commission was charged. *In doing so the indigenous banker assessed* the credit of the party and acted as a banker in the true sense of the term. They were therefore not prepared to give up this type of business. They wanted that the Reserve Bank should first start dealings with indigenous bankers. It should ask them to give up their family business only when it was demonstrated that the same would mean a serious risk for the banking business. They agreed to the exclusion of speculative business. Dealings on the part of the indigenous bankers in gold and silver ornaments should not be regarded objectionable when the indigenous banker became linked with the Reserve Bank. The prohibition of such business would be a great blow to the prestige of the *indigenous banker in his locality. The indigenous* banker therefore wanted that the Reserve Bank should first link up the indigenous banker with the central banking system of the country. It might then gradually stiffen the *terms on which the Bank would provide normal* finance. For normal purposes only a few of the indigenous bankers would approach the Reserve Bank for finance. The Bombay Shroffs Association pointed out that the main benefit of linking the indigenous banker with the Reserve Bank should not be destroyed by a strict requirement that the Reserve Bank would provide only emergency finance. Other business would be eliminated as the volume of banking business increased and when indigenous bankers on the Reserve Bank's register found that their banking business was growing attractive they would themselves give up their non banking business. It was likely that some indi-

genous bankers might convert themselves into joint stock banks but the Reserve Bank should not attempt to have in the beginning and at once that desirable goal which we all agree should be reached gradually and by the process indicated above[1] The Association also pointed out that it would not call upon the members to give information about their capital resources The bankers would give this information directly to the Reserve Bank as and when they would seek registration

The Reserve Bank of India suggested that the ultimate solution of the problem would lie in the development of an open Bill Market in which first class bills could be freely negotiated The Reserve Bank would then extend open market operations to trade bills This would secure for the first class indigenous bankers a direct relationship with the Reserve Bank without compelling them to modify the essential character of their business or to submit to unduly rigid restrictions[2]

Reserve Bank's Scheme Modified in 1941 :

The difference between the view of the Reserve Bank and that of the indigenous bankers centred round the question of giving up non-banking business by indigenous bankers In 1941 the Reserve Bank of India again enquired of the Bombay Shroffs Association regarding the number of members who would like to accept a modified scheme based on agreed proposals to give up non-banking business gradually over a period of time The Bank did not regard it useful to renew the discussion if a reasonable number of indigenous bankers were unwilling to accept an agreed modified scheme Certain indigenous bankers had separated their banking business from non banking business

1 See Appendix B of the Statutory Report
2 See page 3 of the Statutory Report

and the problem would be solved if others followed this example. It, however, realised that many indigenous bankers may not be willing to do so in the immediate future. In such a case, the Reserve Bank would be prepared to agree to some sort of *via media* by modifying the original scheme provided a sufficient number of indigenous bankers were ready to separate their banking from their non-banking business, if not immediately, at least within a definite period of time ; but they should be prepared to take immediate steps to that end. It, therefore, wanted to know the number of members who would join such a scheme.

On behalf of the indigenous bankers it was suggested that the period for effecting legal segregation of banking and non-banking business for approved indigenous bankers should be five years. Accounts should be published and open to depositors of indigenous bankers and to the Reserve Bank and periodical returns could be supplied to the Reserve Bank by indigenous bankers. No assurance was, however, given regarding the number of indigenous bankers who would join the scheme. It was urged that the Shroffs were conservative by nature and would not commit themselves in advance to anything , but the Association would explain the scheme to the bankers and bring in as many Shroffs as possible into it. It was urged on behalf of the Association that unless the Reserve Bank took active steps to bring in the indigenous banker within its scope, one of the main objectives of the Reserve Bank, namely, to supply credit to the agriculturists in the interior at a reasonable rate of interest, would not be fulfilled. The scheme of the Reserve Bank to supply credit to the agriculturists without linking indigenous bankers with the Reserve Bank and extending credit indirectly through the joint stock banks would not be helpful in providing agricultural finance at reasonable rates of interest,

The joint stock banks did not have the necessary machinery to bring the scheme into operation [1]

Sir Chunnilal B Mehta pointed out that in submitting the Statutory Report the Reserve Bank authorities may have satisfied their technical conscience but they did not discharge their obligation in a just and fair manner. The Reserve Bank authorities have practically discarded all the recommendations and suggestions of the Central Banking Enquiry Committee, Sir George Schuster, the central legislature and other commercial associations in India, thrown cold water over the whole scheme, thus denying to the indigenous bankers any position in the future *vis a vis* the Reserve Bank." [2]

Critical Estimate of the Reserve Bank's Scheme :

This view seems hardly to be doing justice to the Reserve Bank of India which did make efforts for bringing in the indigenous banker into its ambit It is true that the conclusion to which the Reserve Bank had come was that direct relationship could be extended to indigenous bankers when the latter confined their activities to banking proper by making their principal business the accepting of deposits and generally adopting modern banking methods The intention of the Reserve Bank was that in the interest of his customers and also to bring himself within the banking framework of the country the indigenous banker should organise his business on recognised banking principles and practices In fact the proposals of the Reserve Bank seem to be in accordance with the spirit of the recommendations of the Central Banking Committee, which in paragraph 139 of their report say, It must, however, be remembered that the Reserve Bank can only redis-

1 See letter dated Apr 1 30 1942 written by Bombay Shroffs Association to the *Reserve Bank of India*

2 See speech delivered by Sir Chunnilal B Mehta on February 27 1938 at the 27th annual meeting of the Bombay Shroffs Association

count bank-endorsed paper We therefore propose that only such indigenous bankers as are engaged in banking proper or are prepared to shed their business other than banking, should be eligible to be placed on the approved list of the Reserve Bank in the same manner as joint stock banks" The Committee further say in paragraph 144 It is quite conceivable that a large number of indigenous bankers whose principal business is not banking or who do not take to banking as their principal business as soon as the Reserve Bank is established will still remain outside the scope of our proposals These will continue to obtain their banking facilities from the joint stock banks including the Imperial Bank of India '

The Committee had further suggested in paragraph 140 of their Report that such of the indigenous bankers whose deposits did not exceed five times their capital should during the first five years of the working of the Reserve Bank be exempt from the rule relating to compulsory deposits At the end of that period it would be left open to the Reserve Bank to take such action in the matter as it may consider necessary in order to make its credit policy effective"

It is thus clear that the proposals of the Reserve Bank as embodied in Appendix A of the Reserve Bank's Statutory Report for linking the indigenous banker were based strictly on the Report of the Central Banking Enquiry Committee. It is, therefore, not clear as to how, according to Mr. Shroff, the Reserve Bank authorities 'have practically discarded all the recommendations and suggestions of the Central Banking Enquiry Committee' The Indian Central Banking Enquiry Committee left it to the Reserve Bank to see that institutions receiving rediscounting facilities from it were not charging to the public unduly high rates They

also recommended that the Reserve Bank and the commercial banks in India might use such indigenous bankers who were members of the Reserve Bank system as agents for collection of cheques and bills in the same manner as they might use a joint stock bank or a co-operative bank This proposal was made to improve and raise the status of the indigenous banker in India The Committee further recommended that an association of all banks and bankers should be formed at an early date and that such indigenous bankers whose bills the Reserve Bank decided to accept should become full members of the All-India Bankers Association and such of the banks and indigenous bankers as were outside the Reserve Bank system might be made associate members. In the opinion of the Committee, this proposal, in addition to giving indigenous bankers a status, would also tend to raise the standard and improve their banking methods. The Committee wanted the indigenous bankers themselves to carry out these reforms. They said, "We are of the opinion that if they (indigenous bankers) bring their system of operations more into line with the customs and practices of commercial banks in the matter of audit and accounts, use of bills and cheques prompt payment and receipt of moneys and conduct of business strictly in accordance with legal requirements they can take their place in the banking system of the country . We feel that if the better class of both money-lender and indigenous banker would carry out the reform we have suggested, there are considerable possibilities of mutual benefit for both joint stock banks and their indigenous agencies, as well as benefit to the trading community as a whole by the provision of improved banking facilities"

The view of the Reserve Bank of India is that the Shroffs' Association suggest a period of five years for legal segregation thereby implying no change in

the meantime That is to say, there is no possibility of introducing any scheme on the lines recommended by the Central Banking Enquiry Committee which involves the discarding of non-banking business According to the Reserve Bank, the time factor is of vital importance as throughout the history of this problem the possibility of the Bank s having even temporary relations with indigenous bankers carrying on mixed business has been excluded as being patently unsound The Bank lays emphasis on the separation of banking from the non banking business even after the formulation of the original proposals for an Indian Bank Act It wants to confine the term bank' to institutions carrying on banking business only The Bank's view is that it would be stultifying itself if it were to accept any scheme involving the retention of mixed business even as a temporary measure. It does not think that insistence on this will mean an unreasonable sacrifice to the indigenous banker , because any firm which is doing other than banking business has, if it so desires, a perfectly simple method available of expresssing this decision by floating a separate banking company Perhaps several firms have done so in the last several years They can even carry on their non-banking business as an entirely separate concern with separate assets and liabilities. The Bank finds it difficult to see how a firm which is unable or unwilling to give up its non-banking business will give up that business after some period of time In the meanwhile, the Bank's recognition might induce people to deposit money with the firm and if it failed and the depositors' money was held by the Court to meet liabilities for non-banking losses, the Bank should be sharing in the blame. But it may be conceded that even with legal segregation there is a possibility of a fraudulent concern utilising its banking subsidiary for the benefit of its non-banking business That does not, however, mean

according to the Reserve Bank, that it should not insist on measures which would restrict such a result to occasional cases, which are bound in course of time to be detected when the public learn to study balance sheets and to differentiate between fraudulent and sound concerns which exist for banking purposes only

Grounds for Reserve Bank's Refusal to Proceed with the Scheme :

The Reserve Bank thus refused to proceed with the scheme on two grounds: (1) the indigenous bankers want time to segregate their banking from their non-banking business which the Reserve bank is not prepared to concede It wants immediate segregation before it is prepared to grant direct rediscounting facilities to them, (2) it wanted the offer of at least a number of the indigenous bankers definitely to accept any scheme embodying the modifications urged by the Shroffs Association The fact that the Shroffs would not like to commit themselves in advance to any thing and, would give only an assurance that if an acceptable scheme were introduced, the Association would take the necessary steps to explain the scheme and bring in as many Shroffs as possible to get themselves linked with the Reserve Bank is not enough in the opinion of the Reserve Bank to prepare a scheme. The Bank regards this as too meagre a basis for recommending to the Government the necessary amendments to the Act. It thinks that like section 17 (4) (*d*) the new provisions would hang in the air and would remain almost a dead letter in the absence of conditions in which it could be applied. It further thinks that there is a risk that even if this concession was granted pressure might be brought to bear to amend the provision itself in the direction of further departure from the principle.

Hence in the opinion of the Bank it would be futile to evolve a workable scheme which would be capable of application on any appreciable scale in the existing conditions According to the Reserve Bank, the Multani Shroffs having most of the hundi business in India showed no interest whatsoever in the scheme They were quite satisfied with the facilities secured from the Imperial and other commercial banks The Chettiar and Marwari Shroffs were also indifferent and the Gujrati Shroffs showed no actual zeal According to the Bank, they think that they cannot make enough money in banking as a separate profession and consequently they would not modify their existing business methods They would seem to be working on a basis of capital which would be regarded as inadequate for banking on sound lines and even if they were to segregate their banking business legally they might not attract sufficient deposits in the moffusil to enable them to carry on their banking business

In view of these facts the Bank did not proceed with the scheme. The only contact so far established with indigenous bankers is that the Bank has extended to them remittance facilities similar to those enjoyed by the scheduled banks and further it is of the opinion that in course of time when conditions are more favourable the trend towards legal segregation of banking will increase among indigenous bankers when it will be prepared to bring them directly within its ambit.

The view of the indigenous bankers was further clarified in 1943 when it was pointed out that the Shroffs responded by modifying some of the objections to enable the scheme of the Reserve Bank to materialise; but the Bank shelved the scheme on the ground that the Shroffs' Association would not give in advance the estimate as to the number of Shroffs who would be prepared to work

under the scheme. This requirement was regarded as strange and impracticable The Shroffs wanted that (1) the scheme should be completed and the doors opened and even a very few Shroffs should be welcome. Others would follow as time would pass. (2) Whether or not the scheme would remain dormant or unsound, should be no ground to judge the need of its formulation.[1]

Suggestions .

The indigenous banker is the most important agency for providing funds in the Indian money market So long as he remains outside the direct ambit of the Reseve Bank, it is not possible for the Bank to exercise effective control over the credit situation in the country, It cannot, therefore, serve as a true central bank and without bringing the money-lender and the indigenous banker, the most important credit agencies of the country directly and indirectly, it cannot be helpful in providing credit facilities to an adequate extent for the agricultural industry which is the most important industry of the country. There is no doubt about the fact that the Reserve Bank has made sincere efforts consistent with the practice of central banks in other countries to bring the indigenous banker within its direct rediscounting facilities. It is also a fact that its proposals are based on the recommendations of the Central Banking Enquiry Committee. The difference of opinion between the Reserve Bank and the indigenous bankers is reduced to this that the Bank wants the indigenous bankers to give up their non-banking business and to confine themselves purely to banking business as a condition precedent to the granting of direct rediscounting facilities to them. The indigenous bankers are

1 See speech delivered by Sir Chunni Lal B Mehta on January 15 1948 at the 82nd annual meeting of the Shroffs' Association Limited Bombay

prepared to give up speculative business and to submit their accounts for inspection to the Reserve Bank; but they do not want to give up all their family business, as dealing in gold and silver, etc. According to them, the result which the Reserve Bank authorities desire to see at once, namely, the elimination of all other business would be achieved in due course as the volume of banking business increases. When after some years some of the bankers on the register find that their banking business is of sufficient volume to make it attractive for them to shed all other business, they will not need serious persuasion to do so. The request of the indigenous bankers for the supply of normal finance was considered by the Reserve Bank as against the recognised practice and functions of a central bank; but it proposed to modify the practice by offering to the scheduled banks to rediscount agricultural paper coming from them during normal times. The principle, therefore, that finance from the Reserve Bank can only be made available in an emergency does not stand. The differences between the indigenous bankers and the Reserve Bank are not incapable of adjustment, but, according to Sir Chunni Lal B. Mehta, "the belief is growing that the Reserve Bank is avoiding the main issue." The indigenous bankers think that the Reserve Bank should first prepare the scheme and pave the way for the indigenous bankers to come in. It would be up to the Reserve Bank authorities gradually to stiffen the terms on which they would supply normal finance, driving the indigenous bankers more and more to rely on such deposits as they can attract; but their submission is that this should be done gradually. According to the Association of the indigenous bankers, all the registered bankers would be eligible for loans and advances and discounting facilities but only some of them would make use of the finance from the Reserve

Bank for normal purposes Hence the indigenous bankers point out that the prime benefit of linking with the Reserve Bank should not be destroyed by the strict requirement that finance should be provided by the Reserve Bank only in emergency times The difference is thus very narrow. The Reserve Bank modified its original scheme The indigenous bankers have agreed practically to all the terms except that relating to the immediate segregation of banking from non-banking business The insistence of the Reserve Bank of India on this aspect is perhaps justifiable because if depositors deposit their funds with indigenous bankers and come to grief the blame will be shared by the Reserve Bank of India also But for the Reserve Bank to insist on finding out as to how many indigenous bankers would come and join the scheme as a condition precedent to the formulation of the scheme is to put the cart before the horse Let the Reserve Bank frame the scheme, make it known to the public, get it passed by the legislature and then indigenous bankers would automatically come in as and when they find monetary benefits accruing to them by joining the scheme

It is impossible to over-estimate the importance of the indigenous banker in the banking and credit machinery of India. This organisation represents more than 90 per cent of the whole and the links between the whole of this system and the modern banking system of India are very rudimentary It will not be possible for the Reserve Bank of India to exercise full control over the currency and credit of India without linking the indigenous banker with the Reserve Bank in the same sense in which control is exercised by central banks in Western countries The masses of the rural areas, therefore, will not have the full benefit of credit and banking facilities on reasonable terms and conditions, Hence the fullest use should be made

of the indigenous bankers by adapting their methods so that they may fit in with the modern banking system and the central bank [1]

The importance of the indigenous banker in Indian banking cannot be over-emphasised. Indigenous bankers would be willing to have a chance of direct rediscounting facilities with the Reserve Bank of India They would also like to be able to arrange credits with the Reserve Bank in order to carry them over difficult periods But they would like an exception to be made in favour of those who combine commercial agency business with banking; for they regard commercial agency and banking as inevitable because the former involves moneylending also. The Reserve Bank of India should, therefore, prepare the scheme to bring the indigenous banker within its fold. Under the scheme the indigenous bankers should be called upon to submit regularly balance sheets audited by properly qualified accountants They should be given all facilities provided to scheduled banks including the benefits of the Bankers' Books Evidence Act. Dealings may be restricted to bankers doing banking business only but an exception may be made in favour of a commission agency business in order that a large number of indigenous bankers may join the scheme Thus the Reserve Bank should open its doors to approved bankers on these lines. Perhaps at first many of them may not come forward, but the fact that its doors were open would be an indication of goodwill and might ultimately be a means of forging a useful link between the Bank and the indigenous banking machinery of the country It can be easily realised that if the Reserve Bank opened its doors to carefully selected bankers on reasonably liberal terms, a certain number would come forward Perhaps this might not have been possible sometime

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1 *See Sir George Schuster's speech on the Reserve Bank of India* Bill, 1933 Legislative Assembly Debates Volume VIII No 5 page 2200

back, but the times are changing and the more advanced amongst the indigenous bankers are beginning to realise that, if they wish to hold their own in the modern world they must to some extent, modernise their ways of business

Even in the Bank Act there is no provision for the indigenous bankers The Reserve Bank should therefore make proposals subject to which it is prepared to grant direct rediscounting facilities to the indigenous bankers It may be an Act applying to the indigenous bankers purely defining the scope of their business conditions to which they will have to submit themselves and the facilities which they will be entitled to from the Reserve Bank of India In view of the fact that the difference of opinion between the Reserve Bank of India and the indigenous bankers resolves itself only to one point namely, the immediate segregation of banking from the non-banking business, it should not be regarded as impossible of solution and the benefits which would flow to the country from the act of the Bank in bringing the indigenous bankers within the direct ambit of the Reserve Bank should not be long withheld There can be a separate schedule under which the Shroffs can be linked to the Reserve Bank of India and the latter may give the necessary facilities to the former as it has been giving to the joint stock banks.[1]

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1 In response to my request to Sir Chunni Lal B Mehta seeking a clarification of his views on the question of linking the indigenous banker to the Reserve Bank I was informed that *the spirit of the clause was not kept up in its enquiry by the Reserve Bank and made its report to the Government of India on the subject of linking the indigenous bankers to the Reserve Bank which from the point of view of the Shroffs Association was neither within the spirit of the clause nor sympathetic* " I was further informed that "*the proposal of the Shroffs Association* is that there should be another schedule under which the Shroffs should be linked to the Reserve Bank and that the Reserve Bank should give all facilities to the Shroffs as it has been giving to the joint stock banks (*Vide the letter of the secretary of Sir Chunni Lal B Mehta dated 16th November 1945 addressed to me*)

CHAPTER X

FINANCIAL HELP BY THE RESERVE BANK OF INDIA THROUGH THE MONEY-LENDER

The important part played by the money-lender in the agricultural finance in India and the part that he can play further in this connection if his business is properly regulated has been discussed in Chapter V above The agency of the money-lender should, therefore, make adequate efforts in this direction. This could be done by bringing the village money-lender—the largest supplier of agricultural credit in our country—within the banking structure Without this, as observed in the Statutory Report by the Reserve Bank of India, "the Reserve Bank will not be able to influence or improve agricultural credit in an effective manner"[1] Of course there are great difficulties in establishing such contact between the money-lender and the money market with a view to improving financial facilities for the agriculturists It would not be possible for the Reserve Bank to have direct relations with the money-lender. In its Preliminary Report the Reserve Bank pointed out that money-lenders were not willing to abide by the conditions which would have to be imposed if Reserve Bank transacted business with them. It was pointed out therein that the money-lender could get financial assistance from banks for providing marketing finance. If the scheduled banks can develop this business and discount the bills of approved money-lenders drawn for advances to cultivators against produce, substantial improvements could be

1 See paragraph 41 of the Report

made in this aspect of agricultural finance If such a scheme could be brought into operation, there would be a reduction in the rates of interest at which money would be made available to credit-worthy agriculturists The mere force of competition would secure this

Efforts made by the Bank :

The Reserve Bank of India made efforts to supply marketing finance to the cultivator at low rates of interest but they could not succeed. A Circular No ACD-1/19-38 dated January 3, 1938, was issued by the Reserve Bank to all scheduled banks It contained proposals of the Bank to improve financial machinery of the country to make credit more extensively available to the agriculturists at reasonable rates of interest The village money-lender was to be brought within the banking structure of the country The proposals of the Bank were that in places where branch banking was adequately developed, scheduled banks could obtain personal knowledge about the standing of the agriculturist-borrower In other places the money-lender could be utilized to ascertain the credit-worthiness of the agriculturists and he could be made responsible for the adequacy of security The idea was to provide marketing finance to a larger extent through the money-lender The latter was to draw bills in a form that they could be discounted with the scheduled banks. These bills were to be on the security of the crops of the cultivator The scheduled banks could get them rediscounted with the Reserve Bank It was suggested that in the initial stages special inducement was to be offered to the banks and money lenders in the form of rebates on agricultural bills The Reserve Bank was prepared to rediscount such bills at special rates by granting rebates to scheduled banks in respect of agricultural paper in areas where the agriculturist

was paying a very high rate of interest owing to *inadequate financial machinery.* The benefit of the rebates was to be passed on to the agriculturists. The scheduled banks were asked not to charge a rate exceeding 2 per cent over the Reserve Bank's discount rate The money-lender would pass on credit to the agriculturist with a further margin of not more than 2 per cent. *In that case the Reserve* Bank would grant a rebate of 1 per cent. The fact that the Reserve Bank was prepared to rediscount such bills during normal times would make such finance more easily available The rebate was to apply to all bills and notes for marketing finance of a duration of 9 months The scheduled banks discounting such paper would be responsible for satisfying themselves that the money-lender was creditworthy, that his business was conducted on sound lines, and that he kept simple books of accounts in a proper form Other details for example, agency for collection, form of accommodation from the Reserve Bank, the declaration by the scheduled banks that the bills were drawn for agricultural purposes, the information to be supplied by scheduled banks in respect of money-lenders, etc, were to be considered subsequently. The Reserve Bank invited the opinion of *scheduled banks regarding the prospects of working* the scheme. The Bank further pointed out that it might ask the scheduled banks later on to furnish the list of approved money-lenders whose paper would be discounted by the bank.

Arguments Against the Scheme:

The scheme was not favoured on many grounds First, it was pointed out that the smaller agriculturist did not usually borrow against the security of his produce He required finance, more for crop production than for its marketing. He generally *obtained it by keeping a running account with a* money-lender and he would not, therefore, commit

himself to bills payable at a fixed date This accom modation would be confined to big landowners and dealers and they got finance adequately even under the existing conditions and did not require any special help.

Secondly it was pointed out that the scheduled banks were not in a position to assess the credit of the money lender readily. It would also not be possible for them to dictate the rates of interest which the money lender charged to the cultivators against produce bills.

Thirdly it was suggested that first-class bills of Multanis were discounted at very low rates of interest owing to competition There would therefore, be little scope for scheduled banks for rediscounting such bills with the Reserve Bank even if the Multanis borrowed funds for advancing money to agriculturists

Fourthly it was pointed out that debt relief measures passed in the depression period had introduced the element of uncertainty into the sphere of agricultural credit The money-lender was not willing to utilise his existing funds fully nothing to say of utilising borrowed funds in lending them to agriculturists Further he would not stick to the rate as embodied in the scheme.

Money-lenders who were themselves agriculturists might take shelter behind debt relief legislation The agriculturists who wished to claim relief under the provincial debt relief legislation would be entitled to claim that the debt covered by such bills should be included with his other debts The fact that the bill had been endorsed by the original creditor that is the money-lender, to a scheduled bank and later on by the scheduled bank to the Reserve Bank would not cure the defect even though loans by joint stock banks were exempt from such legislation. The reason is that the original

debt was to the money-lender and the subsequent discounter had acquired the bill with notice of these defects Even the exemption in favour of loans by joint stock banks was not universal in provincial legislation. It might, however, be argued that provincial legislation could be amended to exempt such bills That would not help matters, the essence of the scheme being that such bills in the first instance would be taken by the money-lender and opportunities for abuse and evasion would be obvious.

Funds for Rural Areas :

The scheme was, therefore, abandoned. As already pointed out above, the money-lender is the most important financial agency in the rural areas. His vast capital resources must be utilised for providing cheap finance to the cultivator The lines of reform in the business of the money-lender have already been mentioned in Chapter V above. Substantial money lenders must be linked with the Reserve Bank of India directly or through the agency of the joint stock banks They have vast funds and are migrating into towns owing to the effect of provincial debt relief legislation These funds must be made available for providing cheap finance to the cultivator in rural areas Two things are necessary for this purpose. First, *co-operative movement may be developed in the* rural areas and the money-lender may be associated with management of the co operative societies and land mortgage banks, Or, loans may be given even by joint stock banks on the guarantee of the money-lender to the cultivators against crops The money-lender should be responsible for the security and he may be given an adequate amount of cash for this purpose. Secondly, bill habit must be promoted Standardised bill forms printed in the local vernacular which can be drawn upon the

cultivator should be made available in the rural areas They may be discounted by the money-lender with the joint stock banks and by the latter with the Reserve Bank of India The Reserve Bank of India should stipulate the rate of interest to be charged for such finance to the cultivator ultimately This has been done in many other countries notably in Australia The order of January, 1949, reduced by 5 shillings p. c per annum the maximum rate that may be charged on over drafts and new loans for fixed periods by commerical banks and pastoral companies The rate charged by the Commonwealth Bank on rural credit loans was reduced to 3½ per cent.[1]

Construction of Godowns :

This will also require the construction of godowns In fact the provision for secured advances has been made in Section 17 (4) (*d*) of the Reserve Bank of India Act. Under this section the Reserve Bank might take loans and advances repayable on demand or on the expiry of fixed periods not exceeding 90 days against Promissory Notes of sheduled banks or provincial co-operative banks supported by documents of title to goods which have been transferred, assigned or pledged to such banks as security for a cash-credit or overdraft granted for *bona fide* commercial or trade transactions for financing seasonal agricultural operations or for the marketing of crops Thus advances are to be made against the security of Promissory Notes, and the Reserve Bank of India cannot accept the goods pledged with and in the custody of the same scheduled bank or provincial co-operative bank as collateral The documents of title to goods issued by independent warehousing companies can, however be accepted as a good collateral. This sub section can be taken advantage of only if independent warehousing

1 See Reserve Bank of India Bulletin, July, 1947 page 424

companies providing efficient storage arrangements and having authority to issue negotiable receipts are established The warehouse receipts will be an ideal security for any bank and a Promissory Note supported by it will be eligible for rediscounting with the Reserve Bank of India This will bring about a fall in the rates of interest and increase the volume of finance available to the agriculturists This system of warehousing will lead to smooth and orderly marketing of agricultural produce and the cultivator will secure better price for his produce.

The Fourteenth Conference of Registrars of Co-operative Societies held at Bombay in 1944 recommended the introduction of a system of licensed warehouses The Reserve Bank of India has proposed legislation to facilitate the establishment of licensed warehouses The draft bill proposed by the Reserve Bank of India provides for setting up of licensed warehouses where agricultural produce will be graded, stored and regularly inspected. A warehouse will be under a licensed warehouseman who will get the produce in his personal custody, take proper care of it against theft and other accidents and issue a receipt of safe custody with an undertaking to give it only to the person entitled to it.

One or two provincial Governments have passed Acts in consonance with the provisions of the bills circulated by the Reserve Bank of India. It is necessary that warehousing facilities should be provided to an adequate extent. It is then that the provisions of Section 17 (4) (d) of the Reserve Bank of India Act will be adequately utilised and the services of the money-lender and joint stock banks will also be utilised With the setting up of warehouses it will also be possible to develop a bill-market and thus agricultural financial facilities will be made more widely available by the Reserve Bank of India through these various agricultural credit agencies.

CHAPTER XI

RELATIONSHIP BETWEEN THE RESERVE BANK AND THE CO-OPERATIVE MOVEMENT

The relationship between the Reserve Bank of India and the co operative movement may be discussed from two points of view First, through its Agricultural Credit Department the Bank keeps itself in touch with the movement and makes suggestions from time to time for rectification and consolidation with a view to improving the business of the co-operative banks In other words, the Bank puts forward suggestions to guide the movement along sound lines Secondly, this relationship may be discussed with reference to the manner and method by which the movement is financially helped by the Bank with a view to improving the financial facilities for agriculture We may now proceed to discuss the steps that have been taken by the Reserve Bank of India to help the movement in these ways and we may also suggest lines along which the co-operative movement should be financially helped by the Reserve Bank of India in order that agricultural credit facilities in our country may be improved

Suggestions of the Reserve Bank:

We may first take up the suggestions that have been made by the Reserve Bank of India to improve the co-operative movement In its Statutory Report the Bank promised to issue instructions and circular letters indicating the criteria of sound banking

principles subject to which it would make advances to the Provincial Co operative banks [1] Accordingly the Bank issued a number of circulars in 1938, 1939, 1942 and 1944 indicating the lines along which the movement should be improved and the way in which it would be prepared to grant financial accommodation to it. In its second circular, Reference No ACD 528/77-39 of 12th June 1939, the Bank indicated the lines along which the movement should be reorganized It suggested that co-operative banks should conduct their operations like commercial banks on business principles The main suggestions embodied in this circular are given below

Distribution of Assets

I. It was suggested that co-operative banks should keep 10 per cent of their deposits in the form of cash and balance with other banks and 30 to 40 per cent of the deposits should be invested in Government Securities and Treasury Bills and loans and advances should be made to the extent of 50 to 55 per cent The maintenance of adequate ratio is indeed an important criteria of financial soundness The Provincial Co-operative Banks were to buy and sell Government Securities on behalf of central banks and to keep them in their custody. The central banks were advised to hold at least 25 per cent of their fixed deposits, 30 per cent of their savings banks deposits and 35 per cent of their current deposits in Government Securities and an equivalent amount was to be transferred to the Provincial Bank to enable it to buy Government Securities for them Central banks which could not transfer such funds immediately were to transfer them as and when they received deposits. Thus the Provincial Bank was to act as an investment agency for the affiliated central banks

1 See paragraph 38 of the Report

Period of Loans:

II. The bank suggested that the period of repayment should normally be 9 months in the case of co-operative banks. Loans for a longer period than 9 months could be made up to the maximum of paid-up capital and reserves of the lending bank. It means that co-operative societies could lend money for intermediate-term requirements of their members up to the extent of their paid-up capital and reserves. This provision was criticized in co-operative circles in that members would go to the money-lender if co-operative societies did not lend money to them for more than 9 months[1] It will, however, be seen that the Bank did not prohibit intermediate-term loans, but it suggested that they should be granted only up to the extent of paid-up capital and reserve funds of the co-operative societies and the Bank did not favour the granting of these loans in any case beyond three years. If co-operative banks advance money for productive purposes and their use is supervised, the Bank thinks they can be recovered in most cases in nine months although it realises that in times of crop failure extensions may have to be granted. Ordinarily owned funds should be enough to meet the demand for medium-term loans, but if they are insufficient the central banks were to build up their reserves and increase their paid-up capital.

III. It was suggested that co-operative banks should not generally accept deposits for periods longer than a year or two at the most. Long-term deposits make it difficult for a Bank to adjust its interest rates in accordance with the fluctuations in the money market, and are a source of great embarrassment in times of falling rates. The rates paid on above deposits should not be higher

1 The late Hon'ble Mr Ramdas Pantulu was in favour of money being lent by co-operative credit societies up to five years and in special cases even to seven years for productive purposes

than the Bank rate [1] This suggestion was regarded as disadvantageous to the banks. Sir M L Darling suggested that co-operative banks should receive long-term deposits for 5 to 10 years to take advantage of the prevailing cheap money conditions

The suggestions of the Bank can however be justified on the following grounds —

(*a*) Prior to the depression some co operative banks borrowed for long periods at high rates They could not convert their long term deposits into short term ones Hence they continued paying high interest rates on their deposits but had to reduce their loan rates owing to changes in market conditions.

(*b*) In uncertain times, it may not be possible to forecast with precision the future trends of interest rates It would be disadvantageous to banks if after having accepted deposits at comparatively high rates, they found that the rates had come down

(*c*) If long-term deposits are allowed, it would be necessary to keep in close touch with the changes in interest rates and the Registrar of Co-operative Societies will have to advise the co-operative central and provincial banks with regard to the acceptance of long-term deposits. This will be a heavy responsibility on the Registrar Moreover, changes in interest rates are at times so sudden that by the time his instructions are carried out the conditions may have entirely altered.

(*d*) If a policy of long term deposits succeeds, the gain will be of a windfall nature Moreover, if the banks normally accept only short-term deposits, they can always increase their loan rates when the rates of interest go up

1 The late Hon'ble Ramdas Pantulu regarded this advice of the Bank as too sweeping to be workable in practice See Article in the *Indian Co operative Review* of 1939

(e) If co operative banks take up long term deposits they may be tempted to make an increase in medium term loans which may become long dated ultimately

As a result of experience joint stock banks have come to regard short term deposits and short term loans as a *sine qua non* of deposit banking It is necessary to observe this rule in abnormal times even more rigidly Commercial banks vary their interest rates both on deposits and loans whenever interest rates change and they regard the Bank Rate as their guide By linking their deposit and loan rates to the Bank Rate and keeping a sufficient margin between the two the banks are able to stabilize their profits from sound banking Hence the need for linking up the loan and deposit rates of central banks with those of the provincial banks which in turn should be linked to the Bank Rate so that the credit machinery may move as an organised unit

IV Emphasis was laid upon the separation of short term and long term loans Co operative banks were to state clearly how much of their present outstanding loans against central banks were short term and how much were long term The method of showing overdues was also recommended Co operative banks were asked to advance loans for fixed periods and fix the demand at the time of issuing such loans and calculate the overdues on the basis of such demand Authorised extensions were to be shown separately in the Balance Sheet Fictitious repayments were to be avoided Co operative banks were advised to make inquiries regarding the sources of the repayment of money and the actual purpose of utilising the so-called fresh advances If the loans represented a continuation of indebtedness the Reserve Bank advised to call for repayment in instalments To avoid the

possibility of such fictitious repayment is future the practice of making recoveries in a lump sum at one time and advancing the whole amount soon afterwards was to be stopped Loans were to be advanced in instalments for each operation. Even consumption loans could be given provided within the annual repaying capacity , but they were to be given when actually required.

Provision for Bad and Doubtful Debts :

V. Each co-operative bank was advised to create the full reserve against bad debts and 50 per cent reserve against doubtful debts to be kept separate from the general reserve fund. Irrecoverable bad debts were to be written off from reserves built up for the purpose and where necessary, from the general reserves also. It was also suggested that the total of overdues and bad and doubtful debts should form a very small proportion of the total loans The deposit liabilities of co-operative banks should not usually exceed 8 to 10 times the paid-up share capital and reserves and in calculating the reserves it was presumed that overdue interests would not be capitalised.

VI. Co operative banks were to carry at least one-third of their net profits annually to the reserve fund until it became equal to the paid-up capital and thereafter at least one-fourth of the net profits The spread between the borrowing and the lending rates of co-operative banks was to be sufficiently wide to strengthen reserves Further the reserve fund was to be constituted out of realised profits only and investment outside the movement as prescribed under the Co-operative Societies Act. But investments in first mortgage of immovable property were not recommended. The Bank also suggested that the loan and deposit rates of the central bank should be linked with the lending and deposit rates of the provincial banks which in turn

should be linked with the Bank rate, to produce an organic structure of rates throughout the co-operative movement The suggestion regarding the allocation of net profits to the reserve funds was criticized on the ground that if the percentage of net profits allocated to the reserve fund is raised, the profits available for distribution would be reduced It may, however, be pointed out in this connection that this suggestion of the Reserve Bank is sound. In fact the Act of 1904 required all profits to be carried to the reserve fund. Distribution of dividends was permitted under the Act of 1912 in the case of agricultural societies only. Hence the principle may be extended to such banks as may not be observing it.

Thus the Reserve Bank of India has been making suggestions from time to time for consolidating and rectifying the co-operative movement. It is necessary that the co operative movement should be linked with the Reserve Bank of India so that the latter may be in a position to control the rates of interest to an adequate extent in the rural areas and so that institutional credit at reasonable rates of interest may be available to the cultivator. This requires the reorganisation of the movement on proper lines. So far the movement has touched only a fringe of the agricultural population Hence efforts should be made to strengthen and improve the movement in the rural areas. For this purpose a portion of annual profits of the Reserve Bank of India should be earmarked as is the practice in certain other countries also, to be spent on the co-operative movement

We may now discuss the suggestions made by the Reserve Bank of India to place funds at the disposal of the co-operative movement so that they may be passed on at reasonable rates of interest and in adequate amounts to the agricul-

turists The Reserve Bank of India Act makes provision for granting financial accommodation to agriculturists through provincial banks It places certain limitations on the Bank which must be observed by it unless the Act itself is amended These provisions may be briefly stated as below —

(*i*) Loans and advances to provincial co operative banks against Government Securities or against approved debentures of recognized land mortgage banks which are declared trustee securities (if the Bank considers that the debentures are readily marketable) for periods not exceeding ninety days [Section 17 (4) (*a*)]

(*ii*) Loans and advances for a maximum period not exceeding 90 days against promissory notes of co operative institutions endorsed by provincial co operative banks and drawn for the purpose of financing seasonal agricultural operations or the marketing of crops or rediscounting of such promissory notes and that of bills of exchange maturing within 9 months [Section 17 (2) (*b*) and (4) (*c*)] They have thus to be time promissory notes having a fixed maturity and not demand promissory notes One of the main reasons for insisting on time pronotes is that the Bank should know the exact amount of discount on the bills to be discounted

(*iii*) Loans and advances for periods not exceeding 90 days on the security of promissory notes of provincial co operative banks supported by documents of title to goods which have been duly assigned or pledged as security for cash credits or overdrafts granted by the provincial co-operative banks for the purpose of financing seasonal agricultural operations or the marketing of crops [Section 17 (4) (*d*)]

Limitations Upon the Bank :

Thus these provisions imposed limitations on the assistance which can be rendered by the Reserve

Bank of India to agriculturists The Bank is not allowed to make advances direct to agriculturists. It can grant accommodation only through scheduled banks or provincial co-operative banks Further, it is not authorised to supply long-term finance to agriculturists. It can rediscount agricultural bills drawn for financing seasonal operations or for the marketing of crops It is allowed to lend only for short periods inasmuch as its advances are to be limited to 9 months only Subject to these limitations the Bank has been anxious to make the largest possible use of these provisions.

The first important effort in this direction was made when the Bank issued its first Circular of 14th May, 1938, wherein it laid down the procedure to be followed by co-operative banks for obtaining financial accommodation from the Reserve Bank of India It reserved the right to change the conditions from time to time and call for additional information subject to which it would grant advances or make rediscounts It also advised the co-operative banks to prepare their balance-sheets on uniform lines and a form of the balance sheet was also enclosed The Bank pointed out that it will deal with approved provincial banks and through them with eligible co-operative central banks of the A and B classes. Provincial co-operative banks which wanted to be put on the approved list were to apply to the Officer in charge, Agricultural Credit Department, Reserve Bank of India, Bombay, through the Registrar, Co operative Societies Applications should be accompanied by copies of their audited balance-sheets, profit and loss accounts and annual reports for the last three years as also a copy of their bye-laws Similar information was to be given regarding A and B class central co operative banks if the latters' promissory notes or bills were to be rediscounted or advances were to be obtained against them After scrutinising these statements

the Bank was to prepare a list of approved and eligible banks which could get financial accommodation from the Reserve Bank The Reserve Bank was further to consider whether the business of the applying bank was carried on generally on sound banking lines which was to be judged by the amount of the reserve separation of short term loans and long term loans the proportion of over dues and bad debts to total loans and the provision for them distribution of their assets the rates of interest paid on deposits and the dividends distributed These points were to enable the Bank to judge whether the business of the applying bank was carried on generally on sound banking lines

Provincial co operative banks were to maintain with the Reserve Bank a cash balance of not less than 2½ per cent of the demand liabilities and 1 per cent of their time liabilities in India Free transfer facilities were to be provided for maintaining this account if the headquarters of a provincial co operative bank were not situated at the place where the Reserve Bank had its branch of the Banking Department The Reserve Bank would inform the provincial co operative bank if after judging the above conditions its name was placed on the approved list The provincial bank could get financial accommodation by making an application through the Registrar to the Officer in charge of the Department specifying its requirements under the various clauses of Section 17 of the Act The Reserve Bank was to fix the credit lines for each bank at its discretion after considering the position as a whole The Bank was to be informed of the lines fixed and it should apply to the Manager Reserve Bank s Office in its area when it required actual accommodation The application was to be made from year to year, Financial accommodation was to be granted under the provisions or Section 17 of the Act as given above

In all cases of loans, advances or rediscounting the provincial bank is responsible for payment to the Reserve Bank on the due date and the amount can be recovered by the Reserve Bank by deducting the amount of the co-operative bank concerned. The bills are to be turned over to the discounting bank on the due date and it is the duty of the provincial bank concerned to collect the amount.

Right of the Reserve Bank to ask for Interest-free Deposits :

There has been a criticism that the Reserve Bank of India is not entitled to ask the provincial banks to maintain with it interest free deposits on the ground that the Act makes no provision for them It is therefore, suggested that the Bank should not frame rules to the fact that only those provincial banks which are on its approved list will be financially accommodated. The fact is that provincial co-operative banks have to maintain these balances only during the time that they are borrowed from the Bank and there is no penalty or levy on the defaulting provincial banks for occasional deficits in the minimum balance These balances are to be a part of their cash resources. Further the Reserve Bank of India has a right to demand minimum balances to ensure that the provincial banks as part of the credit machinery of the country should strengthen the credit pool of the country and also the reserves of the central banking institution from which they accept assistance It may also be noticed that there is a concession in this respect in favour of the provincial co-operative banks as compared with the scheduled banks

The Australian Practice :

It may be noticed in this connection that the Royal Commission on the Monetary and Banking

Systems in Australia considered a similar suggestion of the Commonwealth Bank Board making it obligatory on the trading banks to maintain with the central bank not less than a fixed percentage of their liabilities to the public The maintenance of these desposits was to ensure adequate resources for the Commonwealth Bank to exercise control over internal credit. *It would force the banks to* borrow occasionally from the Commonwealth Bank and thus strengthen its control over the credit policy of the trading banks The trading banks were unanimous in their opposition to the proposal on the following grounds First if fixed minimum deposits were compulsory, the trading banks would have to protect their position by holding deposits with the Commonwealth Bank over and above the minimum They would, therefore, hold more idle cash advance rates would rise and their *burden would ultimately fall on borrowers.* Secondly, cash reserves varied with seasonal movements. The fixed minimum would be a serious burden to the banks at other times. Further, it might be more permanent obligation upon the trading banks to keep fixed minimum deposits with the Commonwealth Bank, but by the grant of a special power to the Bank to be exercised only with consent of the Treasurer. The Commission did not, therefore, specify the percentage that may be required to accomplish the purpose, namely, that every trading bank will conform to central bank policy. The recommendation of the Commission in this connection was that trading banks may be required to keep with the Commonwealth Bank a deposit of an amount not less than a certain percentage, that every trading bank should be required *to keep on deposit the same percentage At its* discretion the Board may vary the percentage from time to time within limit fixed by the consent of

the Treasurer.[1] In the case of provincial co-operative banks a similar provision might be made in the Reserve Bank of India Act. This will be a sort of half-way house to meet the demands made by co-operators in India. It is necessary that the borrowing provincial bank must keep a certain percentage with the Reserve Bank but the percentage may be varied at the discretion of the Bank and it should remain in force for the period during which the advance remains with the provincial co-operative bank.

The response to the first circular was poor and, therefore another scheme was prepared in January, 1942 in terms of which the Reserve Bank offered to rediscount bills or promissory notes drawn for financing seasonal agricultural operations or marketing of produce under Section 17 (2) (b) or to make advances under Section 17 (4) (d) at special rates by granting rebates provided the benefit of the rebates was passed on to the agriculturists. To begin with the rebates might be up to 1 per cent, and would be restricted to bills and promissory notes created for the purpose of marketing of crops and that subsequently the concession might be extended to cover bills and promissory notes drawn for financing seasonal agricultural operations. It was expected that the concession would be utilized on a fairly large scale and finance would thus be provided to agriculturists at cheap rates. As mentioned in the Circular dated 18th November, 1944, the expectations were not realized. Only one provincial bank borrowed a small amount under the scheme at 2 per cent and passed on this finance at 2¼ per cent to a central co-operative bank and the latter to a sale society at 3½ per cent. The money thus reached the ultimate borrower at 5 per cent. The Reserve Bank in the latter circular decided to extend the scheme of

1 See pages 227 to 229 of the report of the Royal Commission on Monetary and Banking Systems in Australia.

rebate to cover bills and promissory notes drawn for the purpose of financing seasonal agricultural operations, adding at the same time that the rebate will not be allowed if central banks and provincial banks made loans direct to individuals.

The Co-operative movement must be broad-based:

Thus this scheme had a poor response In spite of this in 1944 another scheme was formulated under which the rebate was extended to cover bills and promissory notes drawn for financing seasonal agricultural operations also Further the rebate was increased from 1 per cent to 1½ per cent in 1946 The existing Bank Rate being 3 per cent the provincial co-operative banks could, under this arrangement, be able to get finance from the Reserve Bank at 1½ per cent The U P Provincial Co-operative Bank availed of this concession up to the extent of Rs 1 40 lakhs. This concession was, in the first instance, temporary up to the end of March, 194[illegible]. In that year, under the scheme credit limits of Rs. 8.30 lakhs and Rs. 1 lakh were sanctioned to the U. P Provincial Co-operative Bank and the Bombay Provincial Co-operative Bank, respectively, in 1946 [1] Actually these facilities have so far been availed of to the extent of Rs 3.55 lakhs It is thus clear that the co-operative movement has not taken advantage of the facilities offered by the Reserve Bank to an adequate extent except when the movement is in difficulties. In many provinces it has surplus funds and it does not stand in need of these facilities. It will not be able to avail of these facilities unless it is sufficiently broad-based so as to embrace all aspects of agricultural economy of our country.

Advances made:

The actual amount of loans granted to provin-

1 See information supplied by the Reserve Bank of India in the memorandum accompanying its letter of January 28 1947.

cial co operative banks and scheduled banks under Section 17 is given below

1941 42	Rs 9 9 9 lakhs
1942 43	Rs 293 25 lakhs,
1943 44	Rs 379 15 lakhs

The advances referred to above were all made under Section 17 (4) (a) against Government Securities to scheduled banks except a sum of Rs 50 000 made in 1942 43 to a provincial co operative bank under Section 17 (4) (c against bills of co operative marketing societies In 1943 44 another Provincial co operative bank borrowed Rs. 20 lakhs against Government Securities under Section 17 (4) (a) to finance seasonal crop loans of primary loan and sale societies through central co operative banks and to finance co operative wholesale stores The loan of Rs 50 000 made to a provincial co operative bank in 1942-43 was in accordance with the Bank s scheme for extending financial accommodation to co operative banks for the purpose of financing seasonal agricultural operations or the marketing of crops at concessional rates

Demands of the Co operative Movement :

It will thus be seen that within the existing framework of a legislation the Bank has tried to give financial accommodation at concession rates to the movement The Reserve Bank has asked for the fulfilment of certain conditions by the movement which may be called a pre requisites of sound banking Loans and advances can be made by taking into account the financial soundness of the borrower There are however certain demands of co-operative associations which the Reserve Bank of India should try to meet, and if necessary an amendment of the Act might be made First the Bank should provide cash credit facilities to provincial co-operative banks and the provincial co operative

banks of Indian States should also be brought within the scope of this Act to ensure uniformity of interests Secondly, it is suggested that Section 17(2) (a) of the Act should be amended to include the provincial co-operative banks so that the urban co-operative banks dealing with small artisans and traders may be able to approach the Reserve Bank through them It has also been suggested that Section 17 (2) (c) which refers to advances for trading in securities should be made applicable to provincial banks. A substantial portion of the annual profits of the Reserve Bank of India should be allocated specially for the development of the rural co-operative movement The interpretation placed by the Reserve Bank of India on Section 17 (4) (d) of the Act should be changed The Bank should advance funds against documents of title for goods and not against transferred documents of title The marketing society which is the creditor in this case cannot create the latter document and in the absence of warehouses, the legislature could not have had the Reserve Bank's interpretation in mind. Of course the Reserve Bank cannot lend against the goods themselves because it cannot hold them as security. It can only lend against documents of title to goods which presupposes the establishment of licensed warehouses as already pointed out above. The scheme of the Reserve Bank for setting up licensed warehouses should go a long way in removing this difficulty.

There is also a suggestion in co operative circles that the Bank should accept Government paper instead of cash balances The Reserve Bank does not regard this as feasible. The cash balances maintained by the provincial co operative banks with the Reserve Bank help the latter to manage the monetary system of the country and also to extend credit facilities to member banks. The Reserve Bank is also helped to exercise some con-

trol over the affiliated institutions The main difficulty in the way of the Reserve Bank in accepting Government paper instead of cash balances is that "it would be cumbersome for the Bank to calculate the day-to-day value of the securities to see if the required minimum is there It may, however, be pointed out that the acceptance of Government paper would have a great convenience to the co operative banks and if the Reserve Bank could see its way to provide this facility to them it should indead be appreciated by them

The Act permits advances to be made only for a period of 9 months. It is not possible for the cultivator always to repay the advance from the co-operative bank in this short period of time Consequently renewals are necessary by the co-operative banks to the cultivators Either this period should be extended by the Reserve Bank to at least 18 months or provision may be made for renewal and if necessary, the Reserve Bank of India Act may be amended to make this possible.

The Reserve Bank of India has of course tried to put a liberal interpretation on the Act and help the movement as far as possible It has extended other facilities also to provincial co operative banks which have joined its scheme of financial accommodation, as for instance free remittance facilities The transfer of funds is promoted between the accounts maintained by the different provincial co operative banks joining the scheme in different offices of the Reserve Bank of India For this purpose central co-operative banks affiliated to a provincial co-operative bank are treated as its branches It is necessary that an All-India Co-operative Council consisting of the Officer-in-charge of the Agricultural Credit Department of the Reserve Bank of India and the representatives of the Indian Provincial Co operative Banks, Association should

be set up to guide the movement and to secure closer contact between it and the Reserve Bank of India. A large part of the complaints that now appear to exist about the loan policy of the Reserve Bank of India may perhaps disappear if such a Council is set up.

CHAPTER XII

HELP TO LAND MORTGAGE BANKS BY THE RESERVE BANK OF INDIA

The Reserve Bank of India gave its views in respect of financing of the land mortgage banks by debentures in a Note circulated to the land mortgage banks and the Registrars of Co operative Societies It has pointed out therein that the conditions prescribed for the redemption of debentures are one sided To keep their lending rates as low as possible the land mortgage banks should make these debentures redeemable at any time after a short notice to provide for the possibility of replacement of these debentures carrying a higher rate of interest by new ones at a lower rate of interest They also like to pay off the debentures to the extent that they recover the money lent out by them every year and for this purpose they make the debentures redeemable by lot every year up to the extent of their resources on account of principal This is unsatisfactory from the point of view of the investor The debenture holders do not have the advantage of capital appreciation but they are compelled to reinvest the money at a lower rate of interest with a fall in interest rates The investor wants a steady yield of his money for a long period without being put to bother himself frequently for finding out new sources for investment The prospect of getting money back at any time is not likely to encourage the investor to go in for these debentures In Madras the procedure worked satisfactorily It should however be remembered that these debentures are guaranteed by the

local Government with regard to principal and interest and they have been declared trustee securities. Thus stand on the footing of loans issued by the Government. The success achieved so far in this respect does not, therefore, demonstrate the confidence of the investors in these banks so much as the idea that the Government stands behind them does Moreover, these debentures have become popular under the conditions of cheap money policy If money becomes tight, people will not choose these conditions Moreover Government guarantee should be a sort of help in initial stages Hence the banks should so organise themselves that as their business increases they should be able to raise finance on their own responsibility and they should not suffer if Government support is not forthcoming The Bank suggested a sinking fund scheme to the land mortgage banks which is being worked in practice.

In its circular of May 1933, the Reserve Bank indicated the terms on which dealings would be done with approved central land mortgage banks It assured advice about the rates of interest. It gave an assurance that in emergency it would grant loans up to 90 days and make advances against approved debentures to central land mortgage banks and to primary land mortgage banks coming through them It also agreed to grant loans and advances against Government paper to central land mortgage banks and to primary land mortgage banks coming through them. So far, however it appears these facilities have not been taken advantage of.

Special help by Reserve Bank Necessary

The Reserve Bank of India has a special part to play in the early stages of the development of land mortgage banks, particularly in promoting the marketability of their debentures. It should accept

debentures of the Central Land Mortgage banks guaranteed by provincial government as security for advances under section 17 (4) This will increase their popularity The view of the Reserve Bank authorities is however different They point out that if they let the public know that the Reserve Bank treats the guaranteed debentures on the same footing as Government loans, the proportion held by the public would increase but by doing so the gulf between the guarantee and non guarantee status would be widened and it would be impossible for the Government ever to discontinue its guarantee The difference between the price of the guaranteed and non guaranteed loans would be very much and the latter might not even find a market The first unguaranteed loan might even be a failure and Government would either have to stop assistance which would be difficult or resume the guarantee.

The provincial government should allow a higher rate of interest on future issues so that the public might be induced to make investments and debentures might be issued by tender in blocks of Rs 10 to 20 lakhs Then the Reserve Bank might come in to take up the residuum of a tender if substantial public support were not forthcoming so as to prevent the marginal rate making the total too high Subsequently in more propitious circumstances it might be possible to put out a non-guaranteed issue The Reserve Bank would then be prepared to give assistance The suggestion of the Reserve Bank is that interest on debentures should be raised and the statutory limits on interest chargeable to agriculturists should be enlarged so that they may vary with the rates at which debentures are floated in the market from time to time By this method a stage might be reached at which the guarantee would be reduced or eventually removed

Loan by The Reserve Bank :

The other alternative suggested by the Bank is that guarantee may be dropped as a temporary measure and a straight loan may be granted to the land mortgage banks and these requirements may be included in the ordinary loan programme of provincial governments.[1] In this connection it may be pointed out that the Indian Central Banking Enquiry Committee suggested that the bulk of the capital of these banks should be obtained by means of debentures and that the Government should guarantee the interest on debentures for the whole period of their currency It was further recommended that debentures carrying Government guarantee in respect of interest should be included among trustee securities if the Government were satisfied that arrangements had been made by the Bank for redeeming these debentures at regular intervals. In case of necessity, the provincial governments could also purchase the debentures.

Views of the Banking Committee :

The Central Banking Enquiry Committee did not directly deal with the question whether the Reserve Bank should advance funds against land mortage bank debentures guaranteed by Government in respect of principal and interest ; but in paragraph 611 of their report the Committee wrote that "if any securities were issued with the guarantee of Government both for capital and interest the question of including them in the list of securities eligible for purchase and sale by the Reserve Bank should be considered " Section 17 (4) (*a*) permits the Bank to lend money against trustee securities and the demand that debentures of central land

1 Reserve Bank of India letter No. ACD 597/62 40 dated the 28th August 1940 Also see article on Land Mortgage Banks by Sher Jung Khan pages 214 and 215 proceedings of the Fourth Conference of the Indian Society of Agricultural Economics

mortgage banks should be accepted as security for advances under Section 17 (4) of the Act seems to be reasonable. It also appears to be in consonance with the spirit of the recommendations of the Indian Central Banking Enquiry Committee contained in paragraphs 221 and 611 read together.

Debenture habit is not unfortunately prevailing in India and the bulk of the capital of these banks can and should be raised by debentures. Government guarantee in respect of interest and principal appears to be necessary in the early stages. The fact that the Reserve Bank will accept them as security for advances will further enhance their status in the eyes of the investors. The Reserve Bank would of course be satisfied regarding the soundness of the bank concerned and the acceptance of this principle should not mean that the Reserve Bank would not consider each case on merit. Eventually where the soundness of the bank is proved over a period of time, the marketability of its debentures will be ensured. However, the Reserve Bank can lay down limits to which it will accept the debentures as security under Section 17 (4).

It is not enough for the Reserve Bank merely to advise the land mortgage banks regarding the terms and conditions on which debentures should be floated. The Reserve Bank of India Act does not of course permit the Reserve Bank itself to undertake the flotation of such debentures. The Central Bank of Chile is permitted to acquire the bonds issued by the Agricultural Credit Institution carrying a Government guarantee. The debenture capital of the Institute amounting to 300 million pesos, which was a debt to the Central Bank of Chile, was taken charge of by the State. In certain other countries also the Central Bank accepts the debentures of agricultural credit institutions as security for loans, provided the debentures carry a

guarantee by the State. The Act should be amended so as to enable the Reserve Bank to undertake the flotation of such debentures itself. Thereby it will be helping the financing of the land mortgage banks to a considerable extent. Secondly, a long-term mortgage bank branch or department must be attached to the Reserve Bank of India on the lines of the Long-Term Mortgage Department of the Commonwealth Bank of Australia. The suitability of the creation of such a department must be carefully examined and the Reserve Bank of India Act may accordingly be amended The creation of such a Long-term Mortgage Department will considerably help the provision of long-term loans to the cultivators through the land mortgage banks

CHAPTER XIII

NECESSITY OF AMENDING THE RESERVE BANK OF INDIA ACT

The Reserve Bank of India Act has need to be amended in several directions As already pointed out in Chapter X, the period of nine months for loans and advances which can be granted for agricultural finance appears to be too small to be of adequate help to agriculturists In certain countries like Australia, Ireland, Russia and Chile, the period is at least 12 months It is necessary that this period should be extended to 18 months to be of real service to agriculturists in our country

The Agricultural Credit Department of the Reserve Bank of India is merely an agency for research work in connection with agricultural credit and it keeps itself in touch with credit agencies in the country. It also gives advice to those interested in agricultural credit problems It is not directly entrusted with funds. It should be remodelled on the lines of the Rural Credits Department of the Commonwealth Bank It should have separate capital of its own amounting to Rs 3 crores to start with, which, in a period of five years, should be raised to Rs 5 crores A portion of the reserve fund should be transferred to this Department Further a part of the surplus profits, at present payable to the Central Government, should also go to make up the capital of this Department. The net profits of the Reserve Bank of India for the year ended 30th June, 1945, came to Rs. 14,89,00,000, and in the subsequent year they came to

Rs. 13,64,00,000. Of these amounts about Rs. 14 69 crores was a surplus payable to the Central Government in 1945, while the corresponding amount payable to the Government on 30th June, 1946, was Rs. 13.43 crores. In this way from 1944 to 1946 over Rs 38 crores were paid to the Central Government A portion of this amount should go towards the capital of this Department. In the case of Australia, 25 per cent. of the net annual profits of the Note Issue Department were appropriated for the purposes of the Rural Credits Department up to a total of £2 million which amount was reached in September 1932 Similarly, a portion of the net annual profits of the Note Issue Department of the Reserve Bank of India should also be appropriated for the purposes of the Agricultural Credit Department or it may be allowed to make advances to this Department. This was also done in the case of the Commonwealth Bank. Further, the Treasury may be authorised to lend a certain sum of money to the Agricultural Credit Department. It should be able to make advances upon the security of primary produce which may be placed under the legal control of the Bank and upon such other security associated with the production or marketing of agricultural produce as the Bank thinks fit. It may not make direct loans to cultivators. but it should make loans to co-operative societies—credit, marketing or multi-purpose—and to such other bodies as may be specified in the Act. Its advances may be made for 18 months Fifty per cent. of its profits may be credited to the reserve fund of the Agricultural Credit Department and 50 per cent. may be placed to the credit of the Rural Development Fund which should be used for promoting agricultural research. This will help the growth of the co operative movement as also improve financial facilities for Indian agriculture. The present functions of this Department

can be taken over by the Department of Research and Statistics which was set up in 1945 This latter Department can collect detailed information about the part played by the various credit agencies of the country. The question of agricultural indebtedness would require special investigation It was in July 1943 that the Agricultural Credit Department of the Reserve Bank of India addressed a letter to registrars of co-operative societies on the question of the effects of war-time rise in prices on the working of co-opertive societies The information supplied was rather of a general character It is reported that the Agricultural Credit Department is making a further study of the subject to gain a complete picture of the effects of prices on rural indebtedness so that measures may be devised for a further reduction in indebtedness A circular has been addressed to the registrars of co-operative societies in the matter"[1] A thorough inquiry should be made into the problem of agricultural indebtedness and the extent of finance supplied by various agricultural credit agencies in India All this information should, however be collected by the Department of Research and Statistics

Further efforts must be made by the Reserve Bank of India to link the indigenous banker with the central money market of the country in view of the fact that the difference of views between the Reserve Bank and the indigenous bankers is narrow The bank should not insist on knowing in advance as to the number of indigenous bankers who will be prepared to join the modified scheme as may be introduced by the Reserve Bank of India The indigenous bankers should, of course, give up their non banking business and conform to other conditions that may be *laid down by the Reserve Bank of India regarding*

1 See page 222 Reserve Bank of India Bulleti April 1947

supplying of information and keeping of accounts from time to time On these lines legislation should be *proposed* by *the* Reserve Bank of India Similarly, the agency of the money-lender should also be utilised and bill habit should be promoted and a form of a simple hundi, divorced from its existing form should be devised, which should be easily intelligible to the uninstructed public It should also take an active part in the setting up of godowns and warehouses so that the provisions of Section 17 (4) (*d*) may be more effectively utilised

The model of the Federal Reserve System in which there are 12 Federal Reserve Banks with the Federal Reserve Board at Washington to control *and co-ordinate their practices* should be *examined* to see if a similar system can be introduced in India. There are many provinces in India, each with special economic problems of its own, and in view of the vastness of the country the American system may perhaps suit the Indian conditions better than the existing system

Long-term Mortgage Department :

A Long-Term Mortgage Department should *also be set up under the Reserve* Bank of *India on* the model of the Commonwealth Bank Department, As pointed out in Chapter V, some foreign central banks also have a Long-Term Mortgage Department The setting up of a Long Term Mortgage Department was in the mind of the Indian legislature when the Reserve Bank of India Bill was under discussion in *1933* [1] *The minority report* of the Indian Central Banking Enquiry Committee has attempted in a way to draw up the constitution *of this Department*[2] The *following* extracts from their Report are apposite in this respect .

1 Read the speech of Mr Sitaram Raju, Assembly Debates Volume VIII, No. 5 page 2215 dated 27th November 1933

2 See page 411 of the Minority Report of the Indian Central Banking Enquiry Committee

In order to work the scheme on a sufficiently large scale and to safeguard the interests of the Government, who guarantee debentures, a land mortgage department would have to be instituted in connection with the Reserve Bank—

'(1) to appraise the requirements and to put forward at a time suitable land mortgage bonds, guaranteed by Government as to interest and principal,

(2) to make arrangements at all intermediate periods for the sale of these bonds to the public and to provide for purchase by the investor on instalments on a suitable basis

"(3) to distribute the amounts raised equitably between the various provinces having regard to their needs and also to the extent to which guarantors are forthcoming in each province,

(4) to administer a sinking fund and other charges and to distribute the interest on land mortgage bonds,

(5) to deal with all agents whether co-operative banks or commercial banks, through whom the scheme is to work, and

(6) to make fundamental rules for the administration of the scheme and to see that these rules are carried out by the agents

'The Reserve Bank would also be able to place land mortgage debentures guaranteed by Government on foreign markets.

'If a land mortgage department is created with the Reserve Bank, there is no need for an apex land mortgage bank in each province"

The capital of this new Department should be Rs 3 crores to start with and in a period of five years it should be increased to Rs. 5 crores. A portion of

this capital should be provided from the special reserve of the Note Issue Deparament and the balance should be supplied by annual appropriations from the future profits of the Note Issue Department and the Banking Department. It should provide long-term finance to primary producers against approved securities at about 4 per cent rate of interest. It should also be allowed to borrow funds The Banking Department should be able to make advance to it subject to terms and conditions which may be agreed upon The funds which are now granted as loans by the Provincial Governments under the Acts of 1883 and 1884 may be placed at the disposal of these two departments of the Reserve Bank of India so that they may be properly allocated in response to the needs of the agricultural credit agencies by these departments. Other details can be worked out by a study of the literature bearing on similar departments existing in foreign central banks The Reserve Bank of India has resources and it carries on correspondence with foreign central banks It should be in a position to make a thorough study of the subject and propose legislation for the constitution of such a department. It may be pointed out that its utility will be immense, particularly in connection with the development of land mortgage banks in our country The abolition of Zamindari subject to payment of reasonable amount of compensation, will require vast funds particularly if the peasant proprietorship system of land tenure is to be created in our country This will require the setting up of a network of land mortgage banks which can raise their funds mainly by debentures This department will be in a position to help the setting up of land mortgage banks and will make advances to them and it will also help them in floating their debentures The possibility of the setting up of an Industrial Finance Department should also be

examined. Now that the Industrial Finance Corporation is to be set up under a special Act of the Indian legislature, its relation with the Reserve Bank of India should be determined

These Departments should issue their annual reports, giving details of their working so that adequate information may be made available to the public. At present practically very little information about the working of the Agricultural Credit Department is given Usually there is a remark in the annual report presented by the Bank to shareholders that the activities of the department received attention during the year and that it continued to study the problems connected with various credit agencies which utilise the services of the department There are quarterly reports of the Reserve Bank of India meant for the directors which contain a wealth of information , but they are not available to the public [1] Such reports should be made available at least to those who are interested in the activities of the Bank If these departments are set up it will be possible for them to publish an annual account of their operations and activities There is a feeling even in informed quarters that the Reserve Bank of India has not come up to expectations particularly in respect of the provision of agricultural credit facilities. This feeling has been voiced at the Co-operative Conferences from time to time and also at the 15th Registrars' Conference held at Madras.[2] The Chief Officer of the Agricultural Credit Department has made efforts at clarifying the position of the Reserve Bank of India in respect of agricultural credit of contributing an article on the subject in the August number

1 The Bank did not also make these quarterly reports available to me saying that they were of a confidential nature

2 Read views of Mr C R Srinivasan Director Central Board Reserve Bank of India in this connection in "Commerce" dated January 20, 1945

of the Reserve Bank of India Bulletin of 1947 He has pointed out therein how some of the complaints and criticisms cannot bear proper scrutiny and has suggested that the Bank "has been genuinely interested in creating facilities and extending agricultural credit in all possible but sound ways". If the suggestions made in this treatise are carefully considered by the Reserve Bank of India and given effect in so far as they are practicable a great deal of the difficulty in respect of the part that the Reserve Bank is playing in regard to agricultural credit will be solved

Now that the Reserve Bank of India is going to be nationalised special provisions in the Act can be made to expand facilities for agricultural credit and the expectations that were held out in this connection when the Bank was set up, should be fulfilled In the amended Act a duty must be imposed on the Reserve Bank of India to pursue a monetary and banking policy to secure the greatest advantage for the people of the country, and to exercise its powers in such a manner as will best contribute to the stability of Indian currency, the maintenance of full employment in the country and the economic prosperity and welfare of the people, with particular reference to that of agriculturists. as in Australia where Section 8 of the Commonwealth Bank Act No. 13 of 1845 imposes a duty on the Bank to pursue a monetary and banking policy, which will secure the greatest advantage to the people The powers of the Bank are to be exercised in such a manner as to promote the stability of currency, and maintain full employment and the economic prosperity and welfare of the country The same duty is imposed upon the Bank of Ireland under Section 6 of the Act

In Australia, Germany, and the U. S. A, there is the Advisory Council system to advise the appropriate authority of the Central Bank with respect to

the monetary and banking policy of the Bank and with respect to such other matters as the Governor may refer to the Advisory Council In the case of the Commonwealth Bank the Advisory Council consists of the Secretary to the Department of the Treasury the Deputy Governor an additional representative of the Department of the Treasury and two officers of the Bank appointed by the Treasurer on the recommendation of the Governor An Advisory Council should be set up in the case of the Reserve Bank of India also consisting of the Controller of Currency the Deputy Governor and a few representatives of the scheduled and provincial co operative banks to advise Reserve Bank on monetary and banking policy Through this Council the Bank can maintain touch with the views of other financial institutions in the country on monetary and banking matters The presence of the representatives of financial institutions engaged in agricultural credit on this committee will be very helpful in expanding agricultural credit facilities in the country

The Reserve Bank of India should also be empowered to control interest rates payable to or by banks engaged in banking business including agricultural credit institutions The Banking Act of the Commonwealth of Australia provides that

(i) The Commonwealth Bank may with the approval of the Treasurer make regulations

(a) making provision for and in relation to the control of rates of interest payable to or by banks or to or by other persons in the course of any banking business carried on by them

(b) making provision for and in relation to the control of rates of discount chargeable by banks or by other persons in the

course of any banking business carried on by them."

It is necessary that the Reserve Bank of India should be empowered to regulate interest rates in the country, with particular reference to agriculture so that this industry may not have to bear exceessively high rates of interest The Commonwealth Bank has fixed progressively lower rates of interest as the maximum rates at which banks and pastoral finance companies may advance funds. Before the maximum rates were fixed by the Commonwealth Bank, banks used to lend at 7 per cent. or more but now the maximum is fixed at 4½ per cent and agriculture has financially benefited The Central Bank of Chile also regulates the interest on agricultural loans charged by the Agricultural Credit Institution and the Agricultural Colonisation Institution. The former is intended to stimulate agricultural production in the country by means of credit. It controls the investment of loans granted by it. At present (August, 1947) its capital and reserves amount to 535 million pesos, of which 37 millions were exchanged for fiscal bonds in the Central Bank. In the case of the Agricultural Credit Institution the maximum interest is 5 per cent per annum and in the case of Agricultural Colonisation Institution it is 4 per cent. per annum These rates include commission and expenses These rates apply if these funds are obtained by these institutions from the Central Bank of Chile It may be pointed out that the rate at which funds are advanced by the Central Bank of Chile to the Institute of Agricultural Economy is 3 per cent per annum; while the rate of interest applied to loans to the public is 4½ per cent per annum

The operations of these institutions are supervised by the Superintendence of Banks. It is the

duty of the Superintendence to see that laws governing these institutions are duly complied with. It carries out inspections and calls for statements of affairs at dates not previously announced, at least four times a year Further, the Board of Directors of the Central Bank maintains a representative before the Councils and Committees of these institutions but his mission is limited to the revision of the documents, which guarantee the credits, the Bank accords to these institutions

The Central Bank of Chile may discount bills to which the Institute of Agricultural Economy is a party. It may also make loans to it on the basis of promissory notes provided they arise from operations covering the purchase of wheat and its by-products or other farm products. The maximum period of these loans is 180 days They earn 3 per cent. interest and the maximum amount is 120 million pesos The Bank can demand a lien of these products, which remain stored in the General Deposit Stores The Institute of Agricultural Economy is not a credit institution. It is, however, empowered to obtain loans from the Central Bank to enable the State to fix prices.

The Reserve Bank Act should also provide for investment of funds in the bonds of land mortgage banks, carrying government guarantee. This will help the establishment of land mortgage banks in India to meet the long-term credit needs of agriculturists. The Bank of England is a shareholder in the Industrial Development Corporation in England and also in the Agricultural Mortgage Credit Corporation. The Bank of Norway is permitted to invest funds in the bonds of the Norwegian Mortgage Bank The Banco Central De Chile is permitted to acquire the bonds issued by the Agricultural Credit Institution up to a maximum of 40 million pesos per annum for not more than ten years.

These bonds can be issued prior authorization of the President of the Republic and on a favourable report of the Committee of Public Credit They are *guaranteed by the State*

The Act should also provide for the licensing of money lenders and indigenous bankers whose names may be entered in a separate schedule Bills bearing their signatures may be rediscounted by the Reserve Bank of India. This will bring the approved indigenous bankers and money lenders within the direct ambit of the Reserve Bank of India Part VI of the Central Bank Act, 1942, of Ireland makes provision for bankers licences and prescribes the duties and obligations of such bankers Such license is granted by the Revenue Commissioners Licensed bankers have to furnish a statement of their banking business to their creditors, unless exempted by the Minister They have to publish their balance sheets in prescribed forms. In certain circumstances, licensed bankers are to make interest free deposits with the Bank of Ireland. Indigenous bankers and money-lenders in India should also be under an obligation to take out a license from the Reserve Bank and those with a minimum amount of capital may be put on the approved list of the Reserve Bank of India and be entitled to rediscounting facilities with the Reserve Bank of India.

There should be periodical conferences between the authorities of the Reserve Bank of India, and the representatives of the agencies engaged in the provision of agricultural credit In America there is the National Credit Committee, represented by leading farm organizations, agricultural credit agencies and the Federal Reserve Banking System as also the co-operative credit agencies This organization discusses the farm mortgage credit situation, and thus there is close contact and

collaboration between the agricultural credit machinery and the Federal Reserve Banking System to the mutual advantage of both. This system may be adopted in India also

When the Reserve Bank of India is nationalized and the Act is to be amended, care should be taken to emphasize the independence of the Bank on the model of Australia and the Bank of England. Under the Commonwealth Bank Act the Bank shall inform the Treasurer about its monetary and banking policy from time to time. In case of difference of opinion, the Treasurer and the Bank shall try to come to agreement, failing which, the Treasurer may accept responsibility for the adoption by the Bank of a policy in accordance with the Government's opinion. In England also, the Treasury can direct the Bank after consultation with it. Similar independence of the Bank must be maintained in India also.

The adoption of these suggestions should go a long way in improving agricultural credit facilities in our country, and in enabling the Reserve Bank of India to occupy its rightful place in the credit system of the country. The benefits of central banking will then percolate in the rural sector also of Indian economy.

CHAPTER XIV

MONETARY POLICY AND AGRICULTURAL FINANCE IN INDIA

It is now regarded as a truism that monetary policy occupies a very important position in the economic life of a country. Money and credit influence the course and volume of economic activity to a very great extent. In fact booms and depressions are connected with the imperfect working of the institutions of money and credit. In monetary theory the problem of the rate of interest has claimed greater attention than other aspects connected with saving, etc. Originally the rate of interest was supposed to be determined by factors like the marginal productivity of capital and abstinence or by factors on the side of demand and supply. In course of time, with the development of central banking it was realized that monetary authority could vary the rate of interest to a certain extent. Hence the significance of Bank Rate increased. For a long time, it was used as an instrument to protect the gold resources of a country and to maintain the Gold Standard. In the beginning, only the short-term implications of the Bank Rate were regarded as significant; but Keynes[1] developed the view that changes in Bank Rate produced changes in the long-term rate, which in turn, affect the level of investment, output aud prices. Subsequently he developed the view that the volume of investment and employment was determined by the rate of interest.[2] According to him the rate of

1. See *Treatise on Money*.
2. See *General Theory* by Keynes.

interest was primarily a monetary phenomenon and that it was not the instrument which equated saving and investment He held that the rate of interest could be established at any desired level by monetary action The volume of investment depended upon the marginal efficiency of capital in relation to the rate of interest Hence a lowering of interest rates would stimulate investment. He was, therefore an advocate of Cheap Money Policy

The objective of cheap money policy is to provide ample funds in the money market to reduce the interest rates so that investment production and employment may increase It implies a structure of low rates of interest which may be the result of two factors Firstly it may be due to an increase in the volume of voluntary saving in relation to demand This fall in the rate of interest may or may not stimulate investment activity Interest rates decline in the downward phase of the trade cycle but investment is not stimulated thereby Secondly cheap money policy may be the result of the efforts of the Treasury and the Central Bank It is in this latter sense that the term cheap money policy is used now According to Keynes there is a chronic tendency for the under-employment of resources in the normal economy. This according to Keynes can be rectified by deliberately lowering interest rates The policy of cheap money has been followed in England and America ever since the depression of the Thirties of this century. This policy is advocated inasmuch as it reduces the cost of public debt and is advantageous to Government. Secondly, low rates of interest also stimulate public works policy In the case of public bodies and public utility concerns whose fixed capital expenditure is larger interest forms an important part of the total cost In the case of banks income and expenditure both fall, the latter more than the former, and there is gain from

rates began to harden towards the close of 1936 The Calcutta and Bombay call money rates ranged between ¼ and ½ per cent during 1936. By 1939, the former went up to 2¾ per cent The Calcutta Bazar Bill rate was between 5 and 6 per cent in 1936, and it went up to 7 and 8 per cent in 1938 and thereafter it remained between 6 and 7 per cent The main factor responsible for this was not heavy Government demands but an increase in private demand caused by increased activity Industrial production increased

In the World War II there was a great increase in currency and credit as a result of increased war expenditure incurred in India and also as a result of a rise in the favourable balance of trade. Inflation gave an advantage to the investing classes who came in possession of large liquid savings The supply of capital goods for private investment was limited. Hence there were huge floating funds in the market. They were used for investment in Government securities or speculation in shares The search for investment reduced interest rates to low levels As a result of the capital issue control in May 1943 the financial resources of the country were mobilized. Between 1939 40 and 1945-46 Government raised Rs 1 200 crores at progressively favourable terms War time activity and Government borrowing created a keen demand for funds. The Imperial Bank hundi rate was raised from 3 to 3½ per cent in November, 1939 at which it remained up to January 1941 For some time money rate also ruled at higher levels but after 1940 the market ruled easy and by 1941 a superabundance of funds was in evidence The cheaper money drive reached its climax in May 1946, when 3½ per cent. paper was converted into 3½ per cent 1976 Loan at 99 per cent or 3 per cent 1986 Loan at par So far the pursuit of cheap money was mainly restricted to the organized money market

During the war period cheap money conditions were not brought about in sectors of Indian economy other than the organized money market, but after the war, Government demands fell and it was realised that cheaper money in the organised section of the money market would only aggravate inflationary tendencies. Our capital resources had been fully employed and the availability of additional capital was limited Cheap money policy in these conditions could only add to inflation, The effectiveness of cheap money depends on the successful operation of a system of controls This was full of difficulties because of the peculiar structure of Indian economy and administrative difficulties. Hence in August 1946 the Governor of the Reserve Bank pointed out that "the benefits of cheap money have yet to percolate to the same extent to the other sectors of our economy, particularly agriculture".[1] He did not advocate any reversal of the trend in the direction of cheap money, but he pointed out that the immediate task was to consolidate the existing position rather than to move further in the direction of cheaper money

After the cessation of the war economy it is necessary that cheap money should spread through all sectors of Indian economy so that a balanced development of economic conditions may be brought about A sound monetary policy should be designed to secure the full employment of our national resources, to maximize production and to raise the standard of living of the people. Cheap money policy will help industrial development by providing ample funds in the money market and by cheapening credit This was not so in India in the past Firstly, cheap money policy after 1930 simply indicated a reduction in the demand for credit. When however, industrial development

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1 Read the annual speech of the Governor of the Reserve Bank delivered to the shareholders in August 1946

was revived subsequently there was no cheap money policy Secondly, owing to the peculiar structure of the Indian money market cheap money has been restricted to the organized sector of the money market and its benefits have not been widely spread The gilt-edged market was the greatest gainer from cheap money conditions; while agriculture remained at the outer fringe of the beneficiaries. Rates have been less elastic in the other sector because of the risk premium which is very great in industries like agriculture In order that the benefits of the cheap money policy may spread to other sectors of Indian economy, it is necessary to improve the structure of the financial machinery so as to permit funds to flow more freely between different sectors of the economy.

As regards agriculture, three factors have to be borne in mind Firstly, a deficient financial organization is a factor to be considered to cheapen the credit system Secondly, the risk premium forms a great element in the cost of agricultural credit, particularly in India. The Indian agriculturist verges on bankruptcy and his credit is very low. Hence Indian agriculture must be put on a profit-making basis to reduce the cost of agricultural credit substantially Thirdly, a special element of cost in the case of Indian agricultural credit is the monopolistic position of the village money-lender, even in places where co-operative societies exist. The money lender is the grain-dealer also, which makes his position even more powerful Hence the element of monopoly rent enters the cost of rural credit to a certain extent. Thus cheaper money conditions in the organised money market do not materially appear to affect cost of agricultural credit. A closer link between rural credit agencies and the organized money market would remove the monopolistic control of the money-lender over the rural credit system in India For this purpose, it is

necessary that all the main constituents and the money-lender should be brought within the direct ambit of the Reserve Bank of India so that the latter may be able to exercise an effective control over the rural section of the Indian money market and thereby adequate credit may be provided on easy terms to Indian agriculture. It is necessary to expand organized banking to moffusil centres so that there may be an influx of funds into rural areas This is likely to be accompanied by an easing down in interest rates in upcountry centres. This will help Indian agriculture considerably.

There are schemes of agricultural development with the central and provincial governments and they must be put into effect in order to provide a balanced development of Indian economic conditions To promote the economic development of the country the demand for investment has to be stimulated by means other than lower rates and the supply of credit has then to be expanded. Cheap money can encourage investment if conditions are favourable. It will not, however, by itself produce an adequate volume of investment and consumption[1] The field for new investment is very large in India The encouragement of industrialization and agricultural improvements, which must absorb the major portion of future investments, must form a part of the policy of general economic development of the country. The demand for new investment will keep pace with the success of the policy of capital equipment and technical personnel. The limiting factor to a policy of expansion in India is the availability of capital equipment. When full employment of our capital resources is reached the scope for further monetary expansion will be limited by the rate at which additional capital equipment is available. Again, investment would come forward only if it is profitable. This requires the mainten-

1. Hansen quoted in the Reserve Bank of India Bulletin. April 1947.

ance of the demand for production. The schemes of development prepared by the Government will provide this demand. This requires an increase in the income of the consumer.

Agricultural improvemenrs in India are indispensable to increase the income of the people. This requires a wide variety of reform in agricultural technique, land tenure, irrigation facilities, and the like. These improvements will largely centre on an improved system of agricultural credit in which there must be a closer link between rural credit agencies and the Reserve Bank of India. The benefits of cheap money policy will percolate to the rural section of the money market if this link is firmly established The Reserve Bank of India should, therefore adopt the practices and policies followed by the central banks of agricultural countries like Australia, Argentina, etc, to improve facilities for agricultural finance in the country.

APPENDIX A

COPY OF "QUESTIONNAIRE" ADDRESSED TO FOREIGN CENTRAL BANKS

1 What are the provisions of the Reserve or Central Bank Act regarding the grant of financial help by the Bank to other credit agencies in the country connected with agriculture ?

2 Is any portion of the profi s of the Reserve Bank allocated or earmarked for agricultural finance ? If so how ? The amount actually earmarked annually may be stated for 3 years

3 Does the Bank provide credit facilities for agriculture by red scounting agricultural bills ? If so, is there any concession regarding period of time and rate of rediscounting for agricultural b lls ? Is there any limit regarding the amount of such bills to be rediscounted ? Conditions if any attached to such rediscounts may be stated How much amount has been advanced during the last three years for which figures are available ? Does the Bank insist that the concession in the rate of discount should be passed on by the agencies to the ultimate borrower ? If so, how ?

4. Are any advances made by the Bank for agricultural finance ? If so the objects, security rates of interest and the agencies to which they are made may be stated The amount actually availed of by the agencies concerned may be stated for two years.

5 Does your Bank provide d rect credit faci) ties to the cultivator or groups of cultivators? If so particulars regarding amounts rate of interest period of time and the objects for which they are granted may be stated The amounts lent in such ways for at least one year may be stated

6 Has your Bank lowered the rate of interest and helped agriculture through its discount policy and open market operations ? If so please give facts and figures to show the effects of these methods on agricultural credit bringing out as to how agriculture has been benefited financially thereby

7 How does your Bank financially help the co operative movement amongst agriculturists ? Details may be given The extent of success achieved may be stated.

8 Does your Bank grant over-draft accommodation or

otherwise place funds at the disposal of Government free of interest or at concession rates for subsidizing rural credit agencies? If so, details may be given How does such finance reach the cultivator? The actual amount availed of by cultivators for a year may be stated

9 *Are there any special Departments of your Central Bank to grant short-term, medium term and long term loans for agriculture? If so, please state their constitution functions, sources of getting funds and operations*

10 Does your bank exercise supervision over agricultural credit agencies in the country? If so, please state the methods, *e g*, inspection insistence on the deposit of interest free balances by the agencies, sending of returns of business periodically, etc

11 Does the Bank specially encourage the exports or discourage the imports of certain agricultural commodities? If so, how and with what effects?

12 Does the Bank contribute any amount towards the capital of agricultural credit agencies or institutions in the country? If so how much and why? In that case, what control if any, does it exercise over such credit institutions?

13 *Has the Bank suggested any changes in the system of agricultural finance in the country? How far such changes have been carried out and with what effect on agriculture?*

14 Has your Bank followed any particular policy to increase the production of agricultural produce in your country in the war of 1939-45 or thereafter? If so, how?

15 Is there any State Bank in your country for providing agricultural finance? What financial help does your Bank give to such State Bank?

16 What are the different kinds of agricultural credit agencies in your country? Their functions and operations may be briefly mentioned In this connection the part played by the private money-lenders and organized credit agencies may be estimated.

APPENDIX B

RELEVANT EXTRACTS FROM REPLIES RECEIVED TO MY 'QUESTIONNAIRE ADDRESSED TO FOREIGN CENTRAL BANKS GIVEN IN APPENDIX A

Australia Commonwealth Bank

Extracts from the Bank's letter dated 1st May, 1947

"With regard to your request for information regarding this Bank and its operations regarding other Australian financial institutions and their operations we think the most convenient method of supplying the information desired is firstly to set out a general survey of the Australian financial system and then briefly to deal with the questions enumerated in the attachment to your letter

Australian Banking System '

The major units of the Australian financial system are the Commonwealth Bank of Australia and the nine main trading banks Each has a number of branches throughout Australia For instance there are some 860 branches of the Commonwealth Bank, each of which conducts all classes of general banking (and savings banking) business The total number of branch banks in Australia is approximately 2 300

Divisions of the Financial System

It is convenient to deal with the various divisions of the financial system under the following headings

(a) The Commonwealth Bank of Australia the relevant functions of which are—
  - (i) its central banking activities,
  - (ii) its general banking business
  - (iii) its Rural Credits Department and
  - (iv) the Mortgage Bank Department

(b) State Rural and Agricultural banks

(c) Other banks

(d) Pastoral finance companies, and

(e) Other lenders

Commonwealth Bank of Australia :

The Commonwealth Bank of Australia was established by Act of Parliament in 1911 and as the central bank (which position it assumed in later years) it is part of its functions to regulate the volume of credit and to direct credit into proper channels at appropriate rates of interest As far as agriculture is concerned, it has always been the policy of the Central Bank that credit should be available to persons engaged in agricultural operations Further reference is made below to the rate of interest at which such credit is available

Through its General Banking Division (see Part IV of the Commonwealth Bank Act) the Bank lends on overdraft terms direct to individuals engaged in primary production, to pastoral finance companies, and to other bodies that, in turn, lend to primary producers Such advances are made at a rate of 4½ per cent per annum or lower

With regard to the Rural Credits Department of the Bank, reference is made to Part VIII of the Commonwealth Bank Act and particularly to section 67 from which it will be noted that, through the Rural Credits Department, the Bank makes advances to co-operative associations, marketing boards and other bodies for the purpose of facilitating the marketing of primary produce in an orderly manner. The Department was established in 1925 and approximately £ 523 million had been advanced by the Bank on Rural Credits terms between the commencement of the Department and 30th June last At present the rate of interest charged for advance on Rural Credits terms is 5½% p a or lower The security that may be taken is prescribed in Section 67 of the Act. Advances are made through the Department for a period of not more than one year and one-half of the net profits of the Department is placed to the credit of a Rural Credits Development Fund, the moneys in that Fund being used for the promotion of primary production Disbursements from this Fund have been made for purposes such as agricultural, farming and pastoral improvement experiments, cattle research, importation of pedigree stock fodder conservation etc The total amount, disbursed in this manner is £ 430,000

The Mortgage Bank Department of the Commonwealth Bank was established in 1943 and it will be noted from section 80 of the Act that, through the Department, the Bank makes loans to persons engaged in farming, agricultural horticultural, pastoral or grazing operations The security that may be taken is prescribed in Section 80 of the Act and Section 82/85 prescribe the percentage of valuation, amount of loan, period,

and repayment arrangements Loans made through the Department total £ 3 600,000 The capital of the Department (see Sections 15, 47, and 76) is being provided 'free" by the Commonwealth Bank The rate of interest charged in respect of loans made through the Mortgage Bank Department is 4% p a for loans for 20 years and 4½% p a for 21 to 41 years

State Rural and Agricultural Banks :

In each State of Australia some special type of organisation has been established for the purpose of providing accommodation for primary producers In three States, Rural Banks have been set up by the State Governments Each such bank is controlled by Commissioners appointed by the State Government Their funds are mainly provided by the issue of debentures guaranteed by the State or by advances made by the State and to a small extent by deposits from the public In one of the other States the function of lending to primary producers is performed by a department of the State Savings Banks In the remaining two States, the corresponding institutions are, in effect State Government departments

In addition, some of the State Governments have set up departments to lend money to returned soldiers and others for the purpose of establishing and maintaining them on the land

The rates of interest charged by the State Rural and Agricultural banks and corresponding institutions vary between 3¾ and 4½% p a *Information with respect to the volume of loans through the organizations mentioned is not available*

Other Banks :

The other Australian banks make credit available on overdraft terms direct to persons engaged in agricultural pursuits and, as does the Commonwealth Bank lend to pastoral finance companies and other bodies and individuals that in turn lend to individual primary producer Although overdrafts are theoretically repayable on demand they are in the majority of cases granted with the knowledge that they will not be repaid for several years at least and, in effect constitute long-term loans Before the War the amount outstanding in respect of loans by trading banks to persons engaged in agricultural and pastoral industries totalled approximately £ 140 million The rate of interest fixed by the Commonwealth Bank as being the maximum rate at which the trading banks may lend money, is at present 4½% per annum

The trading banks are subject to the supervision of the Commonwealth Bank in its capacity as the central bank and

in this regard reference is made particularly to sections 17/22, 27/28 40/47 and 52 of the Banking Act 1945

Pastoral Finance Companies

The pastoral finance companies provide both short term and long term capital to primary producers mainly to wool growers Broadly speaking the basis of the activities of these companies is the sale of wool and their financial operations have been built up as a complement to this function Most of them act as agents for the buying and form a variety of services including—

(a) the storage and display of wool before sale similar facilities being provided for other commodities *e g*, skins hides tallow grain etc and

(b) the sale to primary producers of supplies, farm requistes etc

Pastoral finance companies borrow from banks on overdraft when necessary It is not the practice of the companies to make long term loans bu loans repayable on demand are frequently carried for an indefinite period The maximum rate of interest at which pastoral finance companies may lend is at present 5% p a It is estimated that the total amount of loans outstanding on the books of pastoral finance companies in Australia approximates £ 25 million.

Other Lenders

Most of the finance required by primary producers is obtained from the organizations described above, but there is in addition a considerable volume of private finance provided directly by individuals and indirectly by solicitors and agents on behalf of clients The major part of this finance would be subject to a regulation prescribing 4½% per annum as being the maximum rate of interest that may be charged at present

Questionnaire submitted with your Letter

With regard to the questions enumerated the following information is supplied —

1 As the Central Bank, the Commonwealth Bank is in a position to provide financial assistance to other credit agencies where necessary There is no specific provision that the Bank shall grant financial assistance to credit agencies connected with agriculture There is of course the general power to lend money to any person or body whomsoever (see Section 18 of the Commonwealth Bank Act) in addition

to the specific provision for advances through the Rural Credits and Mortgage Bank Departments

2. With regard to the question whether any portion of the profits of the Bank is allocated for agricultural finance, we refer to sections 15, 47, 64 and 71 and 76 of the Commonwealth Bank Act The amount appropriated from profits during the last three years (to 30-6-1946 for the purpose of agricultural finance approximates £ 1,200 000, being the amount transferred to capital and reserves of the Rural Credits and Mortgage Bank Departments, together with the amount placed in the Rural Credits Development Fund

3 The Bank does not provide credit facilities for agriculture by discounting agricultural bills The practice of issuing agricultural bills has not been adopted in Australia where banks lend the money (repayable on demand) against land and fixed assets, and also against stock and crops.

4 and 5 For information regarding the practice of the Bank in conection with provision of accommodation for agricultural finance and direct facilities to cultivators and groups of cultivators we refer to our comments above and to the provisions of Parts VIII and IX of the Commonwealth Bank Act

6 In its capcity as the Central Bank, the Commonwealth Bank (since March 1942) has fixed progressively lower rates of interest as being the rates at which other banks and lenders such as pastoral finance companies, may lend money Before maximum rates were fixed by the Commonwealth Bank it had been the practice of banks to lend at rates of 6%, 7% and more and it will be noted that we have fixed 4½% p a as the maximum rate at which banks may now make advances The rate for pastoral finance companies has been brought down to 5% Agriculture has of course, benefited financially with other groups in the community The discount policy and open market operations of the Bank have not directly affected agriculture.

7. As far as the provision of financial assistance to the co operative movement is concerned, we refer to our comments regarding the Rural Credits Deparrment of the Bank

8. The Bank does not directly place funds at the disposal of the Government free of interest for subsidizing rural credit agencies.

9 From our remarks regarding the Rural Credits and Mortgage Bank Departments of the Bank and from the pro-

visions of Parts VIII and IX of the Commonwealth Bank Act, it will be seen that the departments mentioned provide short, medium and long-term loans for agriculture. The capital funds of each of the two departments have been provided "free" by the Bank and low rates of interest are charged on advances made by the Bank to the departments.

10. As the Central Bank, the Commonwealth Bank exercises supervision, but does not undertake inspection of the various agricultural credit agencies As far as State banks are concerned, we refer to section 5 of the Banking Act, from which it will be noted that certain provisions of that Act are not applicable to such institutions The Banking Act however, applies to the major banks in Australia and such banks are required by that Act to lodge certain moneys in Special Accounts with the Commonwealth Bank (see Sections 17/22 of the Banking Act) and to follow an advance policy determined for them by the Commonwealth Bank (see Section 27 of the Banking Act) Part VI of the Banking Act sets out the statistics that banks are required to furnish.

11. The Bank does not directly encourage or discourage export or import of particular agricultural commodities.

12 We have referred above to the provisions of the Commonwealth Bank Act relating to the capitalization of the Rural Credits and Mortgage Bank Departments. The Bank does not make any contribution towards the capital of other agricultural credit agencies

13. It had long been considered that the establishment of a Mortgage Bank in Australia would be desirable and the commencement of the Mortgage Bank Department of the Bank in 1943 was a change in the system of agricultural finance introduced by the Bank The commencement of the Mortgage Bank Department constituted a significant event in the financing of agriculture in Australia No other major changes have been made at the Bank's suggestion.

14. The Bank did not lay down any particular policy to increase primary production during the recent war but has been closely in touch with the Commonwealth Government which has taken active steps to effect such an increase. The Bank's Economist and other experts have made important contributions that have assisted in the determination of Government policy.

* * *

Additional information given by the Commonwealth Bank in its letter dated 5th June, 1947.

The General Banking Division of the Commonwealth Bank lends against any acceptable security As far as primary producers are concerned, the security, in the majority of cases consists of a mortgage to the Bank of an estate or interest in land by the borrower

Advances by the General Banking Division for purposes such as to provide primary producers with working capital are not made for fixed periods In this regard we refer to pages 2 and 3 of our letter of 1st May As indicated in that letter the General Banking Division lends to primary producers on overdraft terms (i e, the advances are theoretically repayable on demand albeit they are in the majority of cases, granted with the knowledge that they will not be repaid for a number of years) The period within which repayment will be effected is determined when the advance is approved and varies according to the circumstances, such as the purpose for which the money is required and, in the case of primary producers the class of production in which the borrower is engaged

There is no maximum limit for individual advances made by the General Banking Division to primary producers

The Bank does not publish the amount advanced directly to agriculturists and we are unable to give you figures for the last three years

We assume your enquiry why people go to other bodies when the rate of interest is the same for loans made to individuals and to other bodies arises directly from the statement on page 2 of our letter of 1st May that the General Banking Division lends to bodies that in turn lend to primary producers The question why an intending borrower should approach a body other than the Bank is, of course one for the intending borrower to answer but generally speaking the reason why a borrower approaches another body is that he considers he can obtain better terms, *e g* the provision of additional service For instance as mentioned on page 4 of our letter of 1st May pastoral finance companies provide services relating to storage and display of produce and the sale to producers of supplies etc and thus some producers are 'tied' to individual companies

Advances from the Rural Credits Department (see page 2 of our letter of 1st May) are made to co operative associations marketing boards and other bodies for the purpose of facilitating the marketing of primary produce As recognised by you in the last paragraph on the first page of your letter of 12th May the Rural Credits Department does not lend directly to individuals

for other industries considered to be genuinely national, *i e*, which employ Brazilian prime materials or which exploit the country's natural resources, and also those which are of interest to our national defence

Operations are always carried out by means of signed contracts against special guarantees such as rural industrial or mercantile surety acceptable sponsors and in cases falling under paragraphs (*g*) (*i*) and (*j*) mortgages

Contract terms range from one to ten years as follows:

One year—cases coming under paragraphs		(*c*) (*d*) (*h*)
Two	Do	(*a*)
Three	Do	(*b*) (*e*) (*f*)
Five	Do	(*g*),
Ten	Do	(*i*) (*j*)

Interest of 7% is charged in the case of paragraphs (*a*) (*b*) (*c*) (*d*), (*e*) (*f*) and (*g*) and from 7% to 9% per annum in the case of paragraphs (*h*) (*i*) and (*j*)

Loans are limited

1 To agriculture—up to 60% of the estimated value of the crop immediately following the loan operation "Crop" is understood to mean the complete cycle of vegetable production

2 To cattle—up to 60% of the breeding returns estimated for the term of the operations

3 For improvement—up to the value of the net results obtained through agricultural or rural exploitation during the term of the operation, having strict regard to the paying capacity of the borrower

4 To industry—up to the value of the reforms, improvements or purchases for which the loans are intended, but always having regard to the paying capacity of the financed, taking as basis the estimated output during the term of the loan operation

No loan may exceed 60% of the value of guarantees offered

During 1946, the Carteira de Credito Agricola e Industrial authorized loans (credits opened) to the total of Cr $ 2 319 492 841 00 This figure may be broken down as follows

1946

To agriculture	Cr$	923,158,288,70
To cattle	Cr$	804 875,636 80
To agriculture cattle	Cr$	3,541 700 60
To industry	Cr$	271,422 088 90
To agriculture industry	Cr$	316,495 126,00
	Cr$2	319,492 841 00

7 The Carteira de Credito Agricola e Industrial extends loans for the same purposes and under identical conditions to Co operative Associations

8 When partial or total frustration of pledged crops occurs through no fault or lack of diligence on the part of the financed, making liquidation of the loans impossible on the affixed dates, the Carteira de Cred to Agricola e In l istr al is wont to grant further loans for the maintenance of the crops during the following agricultural seasons In this case, contracts falling due are kept open to be liquidate l with the results of the sale of the new crops

13. The inauguration, in 1937 of the Carteira de Credito Agricola e Industrial of the Banco do Brazil brought about a radical change in the method of financing agriculture in Brazil Up to then, such financing was as a rule carried out by merchants who—at heavy interest rates—advanced part of the purchasing price of the products The new system in practice, which makes the necessary funds available at the lowest possible interest rates in parts and at the right time for the financing of the crops, has proved most beneficial to agriculture

14 Under special legislation decreed by the Federal Government to stimulate the production of foodstuffs the Banco do Brazil through the Carteira de Credito Agricola e Industrial extende l loans in 1946 and will continue to do so in the current year—against mercantile s rety of rice black beans corn sova beans peanut sunflower seeds and wheat—at fixed prices the beneficiaries having the option of selling their products to the Federal Government loans being l qu dated by debit to the National Treasury Operations l eing carried out this year comprise the immediate sale to the Government through the Banco do Brasil of said products

16 Besides the Banco do Braz l (through the Carteira de Credito Agricola e Industial) other banks also grant credit to agriculture

* * *

Canada Bank of Canada

In Canada, the specific responsibility for financial assistance to agriculture rests almost entirely on agencies other than the central bank—although the latter naturally has a keen interest in developments in this, as in any other, fields of credit

Question-wise reply

6 One effect of the Central Bank's open market operations and 'easy money" policy has been an appreciable decline *in the level of interest rates The yield on long-term Government bonds which was about five per cent in the early nineteen* thirties fell to about three per cent by 1936 and is currently about 2 6 per cent Other interest rates have tended to decline by roughly the same amount as in the case of Government bonds At the present the typical rate of interest on agricultural mortgages and farm loans extended by the commercial banks, is 5 per cent, in the early nineteen thirties the comparable rate would have been about 7 per cent

15 The Canadian Farm Loan Board extends mortgage loans to farmers None.

16 Agricultural credit *in the form of* mortgages secured by farm property has been made available through a variety of public and private agencies as well as by private indviduals The most important public sources have been the governments of several provinces, which at one time or another have engaged in agricultural mortgage lending and the Canadian Farm Loan Board Private institutions extending farm mortgage credit have been the life insurance *companies and trust and loan companies In the special field of credit to war* veterans wishing to establish themselves on farms, the Federal Government has provided financial assistance following both world wars Commercial banks provide agriculture with short-term credits and since 1944 with medium term loans for certain purposes under guarantee arrangements with the Federal Government

* * *

Chile : Banco Central de Chile, Santiago

Reply to the Questionnaire

1 (A) The Central Bank of Chile may grant to the Agricultural Credit Institution whenever the latter so requests, direct loans up to a maximum of 200 million pesos, and the said Institution may make use of this authorization by contracting these loans in the form of *promissory notes made out to* the order of the Central Bank of Chile, *at one year's date,*

bearing interest of 1% per annum and without special guarantee (Art 22 of the Organic Law of the Agricultural Credit Institution No 8143 of 11th August 1945)

(B) The Agricultural Credit Institution may effect the following operations

1

2 Issue with the prior authorization of the President of the Republic, and on a favourable report of the Committee of Public Credit up to a maximum of 40 million pesos per annum in credit bills or bonds with mortgage guarantee for a term not exceeding ten years and in the manner and under the conditions established by the Regulations These bonds will be guaranteed by the State and may be acquired by the Central Bank of Chile (Art 4 of the same Law)

(C) The capital of the Agricultural Credit Institution will be made up as follows

(a) (b)

(c) *With 300 million pesos i e the amount of the debt of the said Institution to the Central Bank of Chile of which the State takes charge by virtue of this Law (Art 25 of the same Law)*

(D) The President of the Republic is authorized to issue bonds of the Internal Debt to the value of 370 million pesos These bonds will be allocated to cancel the various obligations which the Agricultural Credit Institution a stock company owes to the Central Bank of Chile and they will be received by this Bank at their nominal value (*Transitory Art 4 of the same Law*)

(E) The bonds referred to in the preceding article will earn interest at 7% per annum with an accumulative amortization of 1% also yearly and they will be exempt from all taxes or fiscal imposts however while these bonds remain in possession of the Central Bank of Chile, they will earn only 2% interest per annum and the rate of amortization will be that corresponding to a bond issue earning 7% interest with 1% accumulative amortization

The Central Bank of Chile may not transfer these bonds without the authorization of the President of the Republic, and subject to a report of the Committee of Public Credit (Art 5 of the same Law)

(F) The participation *corresponding to the Government*

in the profits of the Central Bank of Chile will be destined to meet the service on the bonds dealt with in Transitory Article 4 (Transitory Article 6 of the same Law)

(G). The Central Bank of Chile may discount bills to which the Institute of Agricultural Economy is a party or make loans to it by means of promissory notes subscribed by that Institution provided that these bills or promissory notes arise from operations covering the purchaes of wheat and its by-products, or other farm products . ..

These loans and discounts will be made for a term not exceeding 180 days will earn 3% interest per annum and may not exceed in the aggregate 120 million pesos

The Central Bank of Chile can demand that a lien be constituted in its favour on the wheat and its by-products or farm products which may have given rise to the loan or discount operations The value of the guarantee will be appraised by the Central Bank in each case

The farm products given in guarantee to the Central Bank must remain deposited in the General Deposit Stores (Art 4 of Law No 6241 of 10th October, 1939)

(H) The Central Bank of Chile is authorized to grant direct and indirect credits in the form of loans discounts and rediscounts to the Agricultural Colonization Institution for 20 million pesos. (Art 1 of Law No 5185 of 30th June, 1933).

(I) The credits which the Central Bank may grant to the Agricultural Colonization Institution will earn interest not exceeding 3% per annum, including commissions

Notwithstanding , the credits of the Agricultural Colonisation Institution up to 10 million pesos, will earn 2% interest per annum ,except in cases of delay in payment. (Art 3 of the same Law)

(J) The agricultural co operatives will enjoy the following privileges 6 The Central Bank may discount bills of the agricultural co operatives at the same interest as that charged to member banks (Art 24 of Law No 4531 of 15 January, 1929)

2. See (B) (C) (D), (E) and (F) Since the conversion to fiscal bonds of the original obligations of the Agricultural Credit Institution with the Central Bank, the following sums have been destined to form a fund for meeting the services on these bonds

First half of 1946 ...	$ 8,138,997,40
Second „ , 1946	$ 12,485 815 92
First „ , 1947 ..	$ 16,267,361,85

As indicated under 1 (F), these amounts correspond to the participation of the Government in the profits of Central Bank

3 See 1 (G and (J) Furthermore it must be borne in mind that the Central Bank of Chile, although it is prohibited to grant loans or effect discounts for periods over 90 days, may do so in the case of 'credit instruments fully guaranteed by agricultural products or livestock the due dates of which may be for a period up to six months (Art 54, paragraph 2 of the Organic Law of the Central Bank of 21st August, 1925) The total amount which the Central Bank may lend against documents of a usance more than 90 days must not exceed one half of its paid up capital and reserves

	Discounts and loans to the Inst of Agricultural Economy	Discounts to Agricultural Co operatives	Loans to the public
	Millions of pesos		
June 1944	63	...	100
Dec 1944	53	...	26
June 1945	103	.	106
Dec 1945	44		31
June 1946	66	...	91
Dec 1946	56	..	88
June 1947	27	..	117

(1) To give an idea the heading 'Loans to the public (warrants) has been included as the greater part of these credits correspond to farming operations It is not possible to determine what amount of the bills rediscounted to the banks arise from farming operations nor also those discounted to the public , hence they have not been included in the above table.

The rate of interest for operations with the Institute of Agricultural Economy is 3% per annum, fixed by the respective law The rate of interest applied to loans to the public is 4½% per annum

4 The Agricultural Credit Institution must make all its loans at a maximum interest of 5% per annum including commissions The Agricultural Colonization Institution must grant credit facilities with interest up to 4% per annum including commission and expenses if these are accorded from funds obtained from the Central Bank of Chile within a margin of 10 million pesos and up to 5% on the amount in excess of

same [See 1 (I)] The operations of these *entities* are supervised by the Superintendence of Banks

(1) This is the balance of new loans that is to say, after deducting the credits which were substituted for fiscal bonds

6 From the foregoing answers it is inferred that it has been the desire to *assist* agriculture by means of loans accorded by the Central Bank of Chile to entities of a farming nature and at a very low rate of interest

The results of this policy are *not satisfactory* The following figures serve to give an idea of these results The average level of loans made by the Bank which in one way or another have served to finance agricultural operations during the period 1932 35 was approximately 20 million pesos This level rose up to the end of 1945 to 516 million and in 1946 to 576 million *Notwithstanding the general index of agricultural production* discloses an increase of only 4 8 per cent for the same period up to 1945 (latest figure available)

It must be remembered that this has occurred in spite of the fact that the prices of products have been continually increasing, which should also have served as a stimulant to farmers In effect, during the period mentioned above the general index of the prices referred to rose by 259% up to 1945 and by *315 4% up to 1946*

10 The Superintendence mentioned sees that the laws *governing* these institutions are duly complied with In effect it carries out inspections and calls for statements of affairs at dates not previously advised, at least four times each year *Furthermore the Board of Directors of* the Central Bank maintains a representative before the Councils and Committees of these institutions, but his mission is limited to the revision of the documents which guarantee the *credits* which the Bank accords to these institutions

* * *

Denmark : National Bank

Question wise reply to Questionnaire

3, 4 and 5 See Section in Memorandum

6 See Sections 2 and 3 in Memorandum

7 See section in Memorandum

14 It has been in the interest of the Danish Government during the German occupation, to produce first for the home market and as little as possible for export to Germany.

15 The State loans to agriculture are not administered

by banks, but by the ministries concerned, *cf* Section 5 in Memorandum

16 See Section 5 in Memorandum

Memorandum

As a main rule the National Bank of Denmark grants advances only *through the discounting of commercial bills* of exchange or against collateral security The following securities are eligible Government and municipality bonds, credit association debentures and a few shares subject to public quotation on the Exchange *In the case of loans against* collateral security the Bank has the right to call these loans without giving notice beforehand Generally agriculturists as well as other applicants are able to borrow only subject to these rules, and thus *cannot obtain advances in the National* Bank—for shorter or longer time—against security in real estate live stock or crop the common form of security when lending to farmers The only exceptions are loans granted *against State Guarantee to marl associations e g co operative* associations of ground owners *for carrying out local marl work* These loans are charged the lowest rate of interest of the National Bank p t 4% p a and have a term of 12–15 years *The National Bank may call these loans from the State with* a notice of three months The total amount of loans against State Guarantee was ½ mill Kr as per ultimo 1946

* * *

In the years of crisis after 1930 the National Bank has maintained its lending rules and as a consequence have not on *the whole assisted agriculture by direct lending. On the* other hand the bank has through its discount policy and open market operations caused a lowering of the level of interest and through this channel supported agriculture as well as the *other trades of Denmark This decrease of interest* for agriculture in Denmark financed mainly by long term mortgage loans granted by the credit associations has entailed a conversion of a part of its dear 4½ and 5 per cent mortgage *loans to 4 per cent This conversion involved an amount of* of Kr 500 million or one-third of the *total* mortgage debt of agriculture carrying high rates of interest

* * *

During the German occupation of Denmark from 1940 to 1945 the conditions of the Danish agriculturists were such that it was not necessary to take special subsidiary measures in that period *This was due to the monetary expansion caused by the forced financing by the Denmark's National Bank of the*

export to Germany and the deliveries to the German occupation forces in Denmark Owing to the expansion a marked decrease *in the level of interest took* place so that it became possible for the farmers to obtain long termed *mortgage credits from* the private credit associations at an actual rate of interest of about 3 6 per cent Furthermore, shortly after the occupation of Denmark in 1940 the prices of Danish agricultural *produce were increased very considerably In these ways the* incomes of Danish agriculturists were *greatly improved during* the occupation

* * *

After the end of hostilities in Europe Great Britain again became the principal market of Danish agricultural *produce As prices of agricultural produce in Great Britain* were much lower than the export prices fixed in Denmark *during the War a price agreement was concluded in August* 1945 with Great Britain providing for prices of the most important agricultural produce (butter bacon and eggs) declin*ing according to a certain scale In consequence of this agree*ment the Danish Government was put to the necessity of granting subsidies to the export of agricultural produce Even after the conclusion in July 1946 and February 1947 of new Anglo-Danish Agreements which stipulated *somewhat higher prices of the produce mentioned* the subsidy policy has necessarily been continued As things are, however the administration of these subsidies is outside the scope of our Bank

* * *

Ireland The Central Bank of Ireland, Dublin

1 The Central Bank of Ireland may rediscount certain agricultural bills under powers conferred by Section 7 of the Central Bank Act 1942

* * *

Japan The Bank of Japan, Tokyo

2 Neither allocation nor *earmarking of profits is made* for financing

3 However, it is an *undisputable fact that the Bank of* Japan has contributed much toward smooth operation of the agricultural financing by carrying out discounting of food certificates issued by the Government In Japan, the Government purchases rice, wheat and other staple food, which constitute 40% in the total value of the agricultural products in order to ration the food among general consumers

In purchasing agricultural products, the Government

has made it a rule to deliver the so-called *food certificates*, bearing interest of Sen 1.1 per diem with a period of around one month, to the *Zenkoku Nogyo Kai* or the Japan Agricultural Association, which is the purchasing agent of the Government The certificates thus delivered are known as "the delivered food certificates" In case farmers need cash immediately, the Agricultural Association pays the cash after seeding discount of food certificates by the Bank of Japan

In view of the fact that the Central Co-operative Bank of Agriculture and Industry was acting as the agent of the Japan Agricultural Association as to acceptance and discount of food bonds, actual transactions were made between the Central Co operative Bank and the Bank of Japan It may be added that the Central Co-operative Bank of Agriculture and Forestry is an organ included in the same organizational structure with the Japan Agricultural Association

On and after February 1, this year, the above system has been changed — *to make cash payment for rice, wheat and other* staple food purchased by the Government As the result of the change, the Government in case it needs funds for the purchase of staple food, will hereafter issue bills redeemable within one year or make borrowings at the expense of the "food control special account" The Bank of Japan will accordingly either underwrite the bills or make advances to the special account This will mean accommodation of funds by the Bank of Japan to the Government for the purchase of the agricultural products. In this sense, it may be regarded that the Bank of Japan "is affording facilities for the agricultural industry" indirectly

It may be added that the food certificates purchased by the Bank of Japan during the seven month period between September 1946 and March 1947 which was the principal season for the purchase of the 1946 rice, totalled 15,710 million yen

7. The Bank of Japan assists the Central Co operative Bank of Agriculture and Forestry in its fund operation by accommodating temporarily needed funds The Central Co-operative Bank of Agriculture and Forestry is the nucleus of finance for business of various agricultural co operative unions

* * *

New Zealand · Reserve Bank of New Zealand, Wellington

Section 13 (*d*) and 13 (*e*) of the Reserve Bank of New Zealand Act 1933, authorize the Bank *to discount rediscount,*

buy or sell bills of exchange *arising from agricultural transactions* in New Zealand and a recent amendment to the Act which replaces an earlier provision of a similar nature (Section 13 (*g g*) empowers the Bank to grant accommodation by way of overdraft "to any Board or other authority having statutory powers in relation to the marketing of any New Zealand produce, for the purpose of financing the purchase and marketing of any such produce"

* * *

Sweden : Sverigen Riksbank, Stockholm

The Sverigen Riksbank does not hold any special loans for agricultural credit but, being directly subordinated to the Riksdag, the Bank may be commissioned to administer funds granted by the Riksdag For the time being there is only one such fund namely the spannmalskreditfonden" the purpose of which *is to support the farmers by advancing money on* cereals

* * *

Switzerland : Swiss National Bank, Zurich.

The Swiss National Bank is, by statute, intrinsically an issuing, clearing and discounting bank, and is authorised to conduct only *clearly defined transactions enumerated in the* Bank Act According to these regulations, the Swiss National Bank is allowed among other transactions, to discount bills and cheques issued to "order" arising out of agricultural dealings on condition that

> they are based on commercial transaction, the due date does not exceed 3 months, and they bear at least two signatures of persons known to be solvent and independent from each other

These agricultural bills constituted in the past, however, only a comparatively small amount of the total of the National Bank's holding Only exceptionally did these bills originate from individual farmers Usually they were issued by agricultural co operative societies in order to cover certain export transactions *During the second World War, the Swiss* National Bank also facilitated the financing of agricultural production which had been considerably intensified by way of rediscounting so called melioration bills These bills can be drawn by agricultural corporations rural or municipal communities, and "Kantone" (*i e* the sovereign States within the Swiss Confederation) for the purpose of financing the melioration of land, especially *the clearance of woodland for cultivation*, the draining of marsh land, etc In every case in which

the National Bank placed their credit at the disposal of agriculture it was destined to provide working capital for agricultural development Owing to the special constitution of the bank, loans especially mortgages, cannot be authorised

United States of America Federal Reserve System

While the Federal Reserve Banks do not extend loans directly to cultivators the *condition of the agricultural* segment of this economy is a matter of great concern to the Federal Reserve System Recognition of its importance is found in Section 10 of the Federal Reserve Act, which provides that in selecting the members of the Board of Governors of the Federal Reserve System the President "shall have due regard to a fair representation of the financial, agricultural, industrial, and commercial interests and geographical divisions of the country" Also agricultural conditions are a subject of constant study by the research departments of the Federal Reserve Banks, several of which employ agricultural economists for the purpose

The Federal Reserve Banks have power to discount agricultural paper for banks which are members of the Federal Reserve System In fact for some time practically all credit accommodations afforded member banks by the federal Reserve Banks have been in the form of the member-banks' promissory notes secured by United States Government obligations Formerly, however, a great deal of use was made of the discount facilities of the Federal Reserve Banks and member banks located in rural regions have been greatly aided in financing crop movements by their access to Federal Reserve discounts and advances

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